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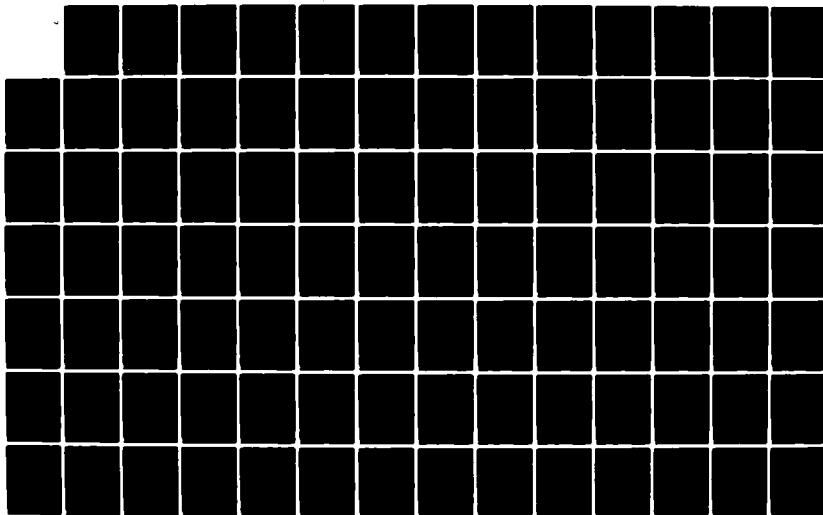
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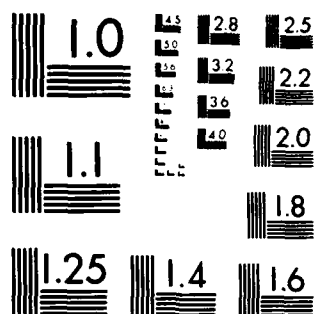
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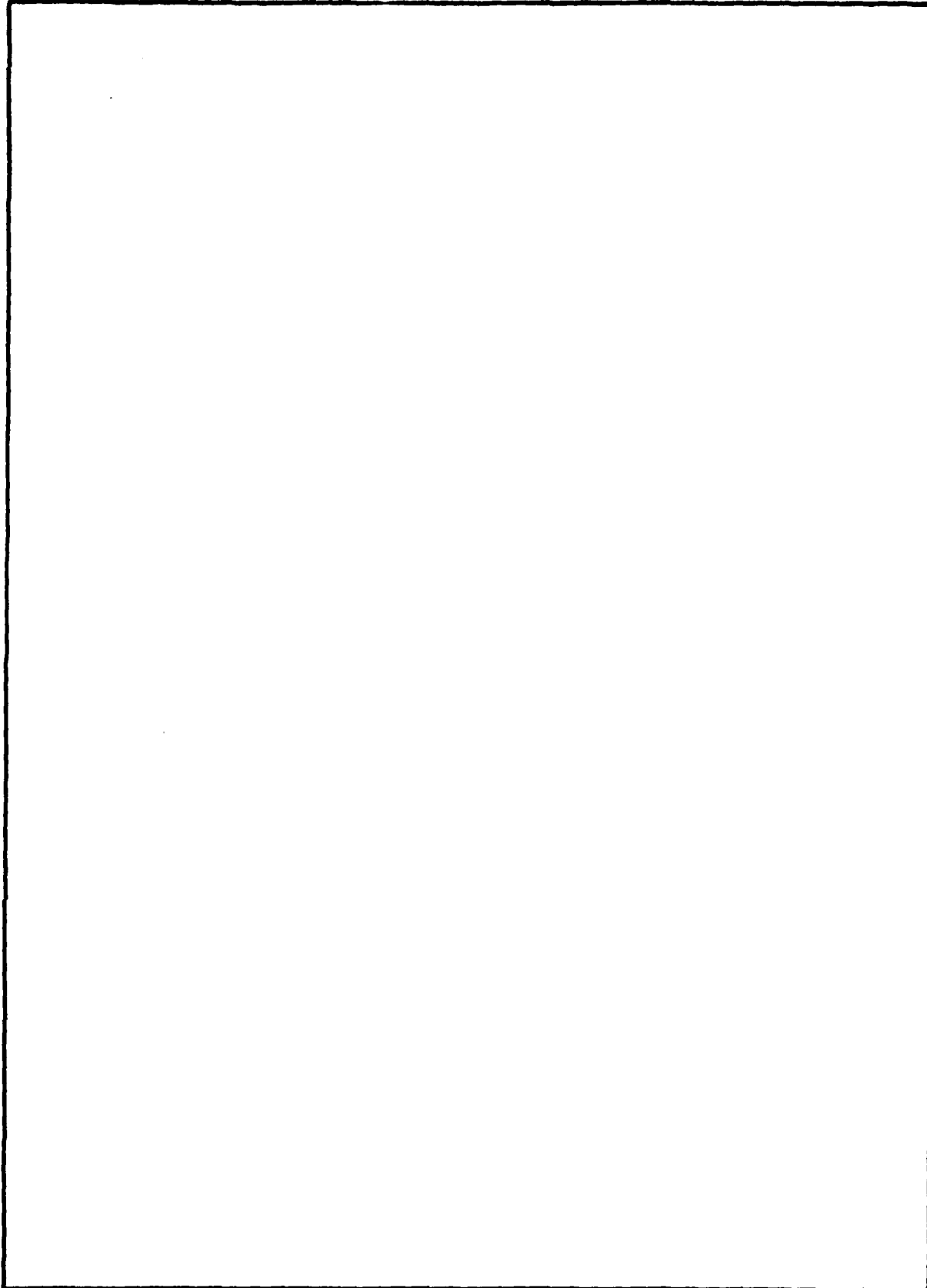
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REMEDIES OF GOVERNMENT SUBCONTRACTORS

Major Joseph F. Cirelli
HQDA, MILPERCEN (DAPC-OPP-E)
200 Stovall Street
Alexandria, VA 22332

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A thesis submitted to the National Law Center
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Satisfaction of the requirements for the
degree of Master of Laws in Government
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REMEDIES OF GOVERNMENT SUBCONTRACTORS

By

Joseph Francis Cirelli

B.A. June 1968, St. Lawrence University
J.D. June 1971, Syracuse University

A Thesis submitted to

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for the degree of Master of Laws in
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Ralph Clarke Nash, Jr.
Professor of Law; Director of the
Government Contracts Program

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INTRODUCTION

In 1966, the issue of the effectiveness of the remedies available to government subcontractors was officially studied by Congress.¹ There it was stated that one of the most difficult and persistent problems revealed by the study was that of subcontractors who found themselves with a claim for equitable adjustment of their subcontract that was generated by governmental action.² Because the government's waiver of sovereign immunity for breach of contract claims in the Tucker Act³ has been construed as only applying to express and implied-in-fact contracts and because the subcontractor has normally been unable to demonstrate the existence of such a contract with the government, he found that frequently there was no judicial relief available against the government.⁴ Similarly, the Contract Disputes Act⁵ is also limited in its application to express and implied-in-fact contracts.⁶

As a result of these limitations on the government's waiver of sovereign immunity, the subcontractor who has a claim generated by government action is forced to rely upon his prime contractor to sponsor his claim before the courts and boards, either by asserting it on his behalf, or by

allowing the subcontractor to use his name. Or, he must creatively demonstrate how, through his relationship with the government, he was in privity of contract with the government. While this system may frequently work without injustice, it does offer the possibility for unjust results in those instances where the prime contractor may resist the subcontractor's attempts to assert a claim, or where he may no longer be available to assert the claim in the subcontractor's behalf.

On the other hand, in 1972, when the Commission on Government Procurement submitted its report to Congress on an evaluation of the systems for administrative and legal resolution of disputes which may arise in the performance of government contracts, it expressly rejected any proposal to change the rules regarding the presentation and handling of subcontractor claims.⁷ This decision was made despite the fact that a majority of the members of the Commission's Legal Remedies Study Group recommended that subcontractors be granted direct access to the contracting officer and government disputes procedures for claims arising from government acts or omissions.⁸ The refusal by the Commission to adopt this recommendation reflected both the Commission's doubts that a significant problem actually existed and its concern that the proposed changes might have an undue impact on the number of claims presented for

resolution by contracting officers. In essence, it was felt that there was insufficient data to justify either adopting the recommendations or to assess their potential impact.⁹ The significance of the Commission's failure to recommend change is evident in the Senate Report on the Contract Disputes Act, wherein it is clearly stated that the recommendation of the Commission was adopted concerning the continuation of the sponsorship rules.¹⁰ Thus, it is unlikely that subcontractors will receive legislative relief in this area in the foreseeable future.

Consequently, in those circumstances where subcontractors are adversely affected by government acts or omissions, they must carefully assess the facts and circumstances surrounding the action as well as their contractual relationship with their prime contractor, in order to determine where relief may be available. It is the purpose of this paper to examine the law in this area, in order to ascertain the requirements for gaining recovery from the government, or in the alternative, from the prime contractor. Ultimately, such choices of avenues for relief may require early decisions as to the forum in which to proceed and which claim to assert, and it is the intent of this paper to provide sufficient background on the law in this area so that these choices may be made in a manner which will provide the best opportunity to receive equitable results.

CHAPTER I

RECOVERY FROM THE GOVERNMENT

In the situations previously described, wherein the subcontractor has been adversely affected by government acts or omissions, it seems obvious that it would be most equitable, and advantageous, from the subcontractor's point of view, for him to be able to recover directly from the government. If he is able to do so, there will be no need for cooperation from the prime contractor and there will be a greater likelihood that all relevant factors will be considered in arriving at a settlement. Additionally, and perhaps most importantly, the chances of collecting a settlement or judgment rendered in favor of the subcontractor will be much greater. Finally, a direct action by the subcontractor against the government will lessen the possibility that an injustice is done to the prime contractor or to the subcontractor because there will be no chance for inconsistent results between an action involving the prime contractor and the government and a second action between the two contractors.

In the leading case addressing the factors necessary to find privity of contract between the government and the subcontractor,¹¹ the Court of Claims, after granting the government's motion for an order directing the commissioner of the court to omit from his report any findings of fact concerning claims presented by the prime contractor on behalf of subcontractor,¹² considered whether privity of contract between the government and the subcontractor existed by virtue of certain specifications in the prime contract. These required that the prime not award any work to a subcontractor without the contracting officer's prior written approval and that the terms of all subcontracts be subject to the prior approval of the contracting officer. It was further required that subcontractors be made subject to all terms of the prime contract (including the government's termination powers).¹³

The court first rejected the argument that a clause which specifically denied the creation of a contractual relationship between the government and subcontractor could preclude it from finding that such a relationship existed. However, the court went on to say:

While the quoted provisions of the contract specifications come near to creating privity of contract between the Government and the subcontractors, they are in our judgment not sufficient to do so and this court is therefore

without jurisdiction under the Tucker Act to consider the claims brought by the plaintiff for the benefit of the subcontractors.¹⁴

Thus, it can be seen that something more than a series of clauses in the prime contract which give the government control over the award of subcontracts is necessary to show the existence of privity of contract between the government and the subcontractor. Nor will the fact that the United States will ultimately pay the subcontractor's costs through the prime contractor create a contractual relationship between the government and the subcontractor.¹⁵ It is necessary for the subcontractor to show something more in the nature of direct dealings between him and the government or one of its agents, or a contractual relationship between the government and the prime contractor which was intended to confer enforceable rights on the subcontractor, before he will be able to successfully maintain an action directly against the government under the Tucker Act or the Contract Disputes Act.

Express or Implied Contracts

Obviously, if the subcontractor can show an express written contract between him and the government, he would be able to maintain either a breach of contract action or an appeal based on a claim relating to that contract before a board or the Claims Court. Similarly, it would appear that

if the facts and circumstances surrounding the dealings between the parties indicated the existence of an implied-in-fact contract, the waiver of sovereign immunity would also be clearly established. Therefore it is necessary to ascertain exactly what elements are necessary to demonstrate that an implied-in-fact contract exists.

An implied-in-fact contract has been described by the United States Supreme Court as a contract,

...founded upon a meeting of the minds, which, although not embodied in an express contract, is inferred, as a fact, from the conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding.¹⁶

Additionally, because the government is not bound by the unauthorized acts of its agents,¹⁷ such unauthorized actions cannot form the basis of a meeting of the minds unless subsequently ratified by competent authority.¹⁸

In Silverman v. United States,¹⁹ an implied-in-fact contract was found where a subcontractor court reporter, who had been transcribing Federal Trade Commission (FTC) hearings for his prime contractor, mailed two of the transcriptions to his prime contractor C.O.D. because the prime had been delinquent in paying him for past services under the contract. When the prime contractor did not pay the current and past due amounts, Silverman refused to release the transcriptions to the prime contractor.

Thereafter, a senior FTC official requested Silverman to release the transcripts to the FTC, but he refused to do so without his money. Although the FTC official was not a contracting officer, he did have authority to approve vouchers for payment, and he promised that Silverman would be paid, even if the prime contractor went bankrupt.

Based upon this representation, Silverman released the two transcriptions. Inasmuch as Silverman had no obligation to release these transcripts, and the senior FTC official was aware that Silverman had not been paid by his prime contractor, the promise to pay served as consideration for the release of the transcripts to the FTC, while the delivery of the transcripts to the FTC provided the necessary consideration flowing to the government. At this point, had the FTC official had authority to enter a contract, it could be said that an express agreement had been formed. However, because of the lack of authority, the court was forced to construe the FTC's acceptance of benefits flowing from the promise as a ratification of the agreement, which created an implied-in-fact contract.²⁰

The classic case where the actions of the parties were construed by the courts to create an implied-in-fact contract occurred in United States v. Georgia Marble Co.,²¹ which involved a subcontractor on a government

construction project who had shipped a large amount of loose marble to the site to be used in the construction. When the prime contractor defaulted on his contract, the government, under a right conferred in the prime contract, took possession of the materials on the site and furnished them to the follow-on prime contractor for use on the project. This seizure included the loose marble even though title to the marble had not passed from the subcontractor to the prime contractor. It is important to note that prior to this taking, the subcontractor had advised a representative of the contracting office that the marble was his property, and had also asked who would pay for the marble and the government's construction engineer in charge of the project indicated that the government would take care of that later.²² However, after the marble was installed, and the subcontractor presented a claim for payment for the marble, he was advised that the United States recognized no obligation to pay for the marble.²³ Thereafter, suit was filed under the Tucker Act for the value of the marble seized.

The government defended the suit on the basis that there was no jurisdiction under the Tucker Act because there was no contract to pay the subcontractor.²⁴ The court disagreed with the government's position and found that when

the government took the property it knew that it did not belong to the general contractor and it also knew that it had no right to take property not belonging to the general contractor. Consequently, the court found that the government intended to take the marble and devote it to a public use and pay for it.²⁵ This implied promise to pay, inferred from the actions of the parties, conferred jurisdiction under the Tucker Act. Had such a promise not been found, the subcontractor would have been unsuccessful as his bases for recovery could only have been quasi-contract or conversion.²⁶

This also illustrates that in these cases the courts will frequently find an implied-in-fact contract because the government was unjustly enriched since there is no quasi-contractual relief available against the government. In Georgia-Marble the court appeared to find an implied-in-fact contract because the government's inspector knew that the subcontractor's property was being taken. There was only a vague reference to the fact that payment would somehow be taken care of later and the court seized upon this to find that an implied-in-fact contract was created. Otherwise, the court would have had to allow the government to wrongfully take the property and leave the subcontractor without a remedy.

The case of A.C. Davenport & Son Co. v. United States²⁷ also illustrates how an implied-in-fact contract is likely to be found when the United States bargains for something of value directly with the subcontractor. Here, the subcontractor and prime contractor entered into an agreement to have payment from the government go directly to the subcontractor. The agreement was accomplished by the prime contractor sending a letter advising the government to modify the prime contract by changing the payment address. A government officer approved this change and agreed to send the payment to a special bank account from which the subcontractor could withdraw funds owed on the subcontract.

Despite the government's agreement to this modification, two checks were still mailed directly to the prime contractor. When it was notified of this mistake, the government agreed to stop payment on the checks and issue duplicate checks to the subcontractor. However, the government subsequently failed to stop payment on the two original checks and also did not attempt to recoup the money from the now bankrupt prime contractor. Instead, it set off the amount it paid the subcontractor in the duplicate checks against amounts due the subcontractor on other government contracts. The subcontractor then brought suit against the government to recover the amounts which had been set off.

The subcontractor was successful in that suit, ostensibly because the court found that he was a holder in due course of the duplicate government checks and was under no duty to insure that the government collected the original amounts back from the prime contractor. However, the true basis for the holding in Davenport's favor appears to be a recognition that the parties had negotiated an enforceable agreement. This was clear when the court stated:

...Davenport [the subcontractor] had threatened to stop further deliveries, which it had a legal right to do, if it did not receive payment for its prior deliveries. If Davenport had discontinued delivery, the government would have had recourse against Almark [the prime], but not Davenport. As the district court noted, [un]doubtedly it was because of this fact and in order to insure continued delivery that the government consented to stop payment on the checks sent directly to Almark and to issue a duplicate check to Almark c/o Davenport.²⁸

Not all direct contacts between the government and the subcontractor will result in a finding of an implied-in-fact contract because the contacts must be of such a nature as to allow an inference that the parties came to a meeting of the minds and intended to be mutually bound. The case of ABT Associates, Inc.²⁹ provides a good example of this principle.

In this case, the Department of Transportation Board of Contract Appeals declined to find an implied-in-fact contract despite numerous direct contacts between government

officials and the subcontractor. For example, when the subcontractor's relationship with his prime contractor deteriorated, he stopped communicating directly with the prime contractor and went, instead, to the government for technical assistance. When the subcontractor was unable to collect payment from the prime, the government, at the subcontractor's request, convinced the prime to execute an assignment to the subcontractor of all future sums due. It should be emphasized here that the government official involved in doing this insured that the subcontractor understood that he was not in privity of contract with the government. Unfortunately, the prime contractor defaulted on the contract before any further sums were paid, and the government decided that continuation of the contract would not be cost effective even though the subcontractor offered to complete the contract in order to receive further payments under the assignment.³⁰

Thereafter, the subcontractor submitted a claim to the government for sums it was due under its subcontract, and the claim was denied. On appeal of the denial, the subcontractor alleged the existence of an implied-in-fact contract on the basis of the direct dealings between the government and the subcontractor, particularly after it became clear that the prime would be unable to complete the

contract, and also because the government had accepted benefits from the subcontractor.³¹

The board granted the government's motion for a summary judgment because it found first that there could be no implied-in-fact contract because the government employees who dealt with the subcontractor lacked proper authority.³² Secondly, the board went on to say that even if actual authority did exist, the factual record was insufficient to show a contract implied-in-fact. On the contrary, the board found that the extensive contacts had been initiated primarily by the subcontractor to gain the technical expertise and assistance of the government's technical advisor. He did this in order to complete the subcontract in an acceptable manner and preserve his reputation.³³ Under these circumstances it was appropriate for the government to furnish such assistance. The board concluded that the facts did not support an inference that a contractual relationship was intended, but rather that the prime contractor-subcontractor relationship had continued.

This decision is correct because there appears to be no basis for finding a mutual intent to contract. A close reading of the case reveals that the key factors leading to the board's conclusion were that most of the contacts

between the parties were initiated by the subcontractor for his own benefit and the government did not actually take anything of value from the subcontractor. Otherwise this would be analogous to the Silverman³⁴ case because the administrative contracting officer arranged the assignment agreement with the prime contractor and also promised to see that the subcontractor was paid. Had there been a taking of something which the government was not authorized to receive, there may have been a basis for the board to find ratification of that promise.

A final example showing that the contacts between the parties must be of such a nature as to allow an inference of mutual intent to be bound occurred in Operational Manuals, Inc. v. United States.³⁵ Here, the government furnished the prime contractor with a number of documents to be used in the performance of a prime contract, and the prime entered into a subcontract with Operational Manuals, Inc. to act as librarian and custodian of the documents. After the prime contract was terminated for default, the government requested, on two separate occasions, that the subcontractor return the documents. This was not done until eleven months after the latest request, and when the subcontractor returned the documents, he also presented the government with a bill for \$11,655.43 for storage fees. When the

government refused to pay, the subcontractor sued in the Court of Claims alleging a breach of an implied-in-fact contract. This was based upon the government's knowledge that the subcontractor was storing the documents, regular visits by government inspectors to inspect the documents, and government acquiescence in continued billings for the storage.³⁶

In granting the government's motion for summary judgment, the court refused to find a meeting of the minds and mutual consent to be bound based upon:

the mere knowledge of representatives of the defendant that plaintiff had the documents in its possession, the visits of government inspectors to plaintiff's premises, and the receipt of billings for storage from plaintiff by agents of the defendant. . . .³⁷

Rather, the facts indicated a contrary desire on the part of the government, thus again illustrating that actions by one of the parties alone will be insufficient to support an inference that the parties intended to be mutually bound.

It would be logical to conclude that if the facts and circumstances support a finding that an express oral contract exists between the government and the subcontractor, then a waiver of sovereign immunity should also be established. Unfortunately, there is a line of cases which has cast some doubt upon the enforceability of express oral contracts. These are based upon a questionable

conclusion that 31 U.S.C. §200 is, in effect, a government contracts Statute of Frauds.

In the case of The Narva Harris Construction Corporation v. United States,³⁸ the plaintiff negotiated with several parties, including the Department of Housing and Urban Development (HUD) to provide general contractor services on two contracts for the development of a housing project. Prior to entering into any written agreement with the government, plaintiff advised the government that certain cost figures required by the government were too low to develop the project. The government advised the plaintiff that in order to get the project underway, the lower figures had to be used in the contracts, but that they would be increased at a later date in accordance with applicable HUD procedures for increasing mortgage insurance. The government's assurances were only oral, but in each instance plaintiff proceeded with the projects in reliance upon those oral assurances, and ultimately completed each project. However, contrary to those assurances, the mortgage insurance of neither project was raised and the costs were not properly adjusted. Narva Harris then sued for difference it considered to be due based upon the two oral promises.

The government moved for a summary judgment, citing both 31 U.S.C. §200³⁹ and the case of United States v. American

Renaissance Lines⁴⁰ for the proposition that the statute not only precluded recovery against the government on the basis of an alleged express oral contract but that it also precluded the Court of Claims from finding an implied-in-fact contract or from awarding damages in quantum meruit based upon the same facts.⁴¹ Of course, Narva Harris disputed the contention that the statute was intended to allow the government to repudiate an oral contract, but it also argued that if the court did find that the statute precluded recovery on the basis of an express oral contract, then it should still not apply to implied-in-fact contracts or quantum meruit.⁴²

The court, after recognizing that the facts could support the conclusion that there was an express oral contract, declined to decide whether the statute precluded recovery based thereon, but did decide that the statute should not preclude recovery based upon an implied-in-fact contract, even if it were based in part upon the oral representations of a government agent.⁴³ Thus, in denying the government's motion for summary judgment, the court found that there was, " . . . a valid distinction to be drawn between the naked, express oral contract at which \$200 may be directed, and the 'additional facts' from which a contract implied-in-fact could be inferred" ⁴⁴

The lesson to be learned from the foregoing, at least

until the effect of 31 U.S.C. §200 is decided, is that in the absence of a written contract with the government, the subcontractor would be prudent to plead that he is performing under an implied-in-fact contract.

Agency

Contractors have also been successful in recovering claims directly from the government if they are able to demonstrate that they were dealing with a "private" purchasing agent of the government. It has long been recognized that the government is authorized to use such "private" purchasing agents, and the creation of such a relationship either expressly or impliedly, should be sufficient to establish privity of contract between the government and a contractor who dealt with that private agent.⁴⁵

After the passage of the Contract Disputes Act, there was a series of cases which concerned the question of whether the Act afforded subcontractors direct access to the courts and boards in general, and whether contractors could have direct access under the Act if they were dealing with "private" purchasing agents of the government. These cases involved prime contractors who were performing either construction or plant management services for the government,⁴⁶ and the analysis utilized in characterizing

the relationships between the government, the manager, and the contractor is helpful in understanding the factors necessary to establish privity of contract with the government under this theory.

The first of these cases concerned a dispute between second-tier subcontractor and the Department of Health Education and Welfare (HEW) and was decided by the Armed Services Board of Contract Appeals (ASBCA).⁴⁷ Here, the board denied the government's motion to dismiss a certified claim⁴⁸ of a subcontractor which had been submitted on behalf of a second-tier subcontractor. The government had argued that the legislative history of the Contract Disputes Act clearly indicated an intent on the part of Congress to exclude subcontractors from having direct access to the appellate procedures of the Contract Disputes Act. Therefore the appeal must be dismissed because of the absence of the prime contractor's sponsorship and certification of the claim.⁴⁹

While agreeing with the government's arguments concerning the legislative history of the Contract Disputes Act, the board concluded that the government's argument had nothing to do with certification of a claim but only with the requirement that subcontractor claims be sponsored by prime contractors when the subcontractors are not themselves in privity of contract with the government. However, the board reaffirmed the agency rule when it stated that it was

"[e]qually clear, however, although not frequently encountered, are situations in which privity results when prime contractors act as Government agents to place subcontracts."⁵⁰

Thereafter, the board went on to examine the nature of the relationship between Turner, the prime contractor/construction manager, HEW, and the subcontractor, and found that although the prime contract attempted to expressly provide that no contractual relationship was to be created between the government and any contractor with whom Turner dealt with as construction manager, the existence of certain clauses under the prime and subcontracts was sufficient to establish privity of contract between the government and the subcontractor. These clauses gave government the following rights: to inspect; to be the sole authority to reject the work; to interpret drawings and specifications; to make decisions concerning equitable adjustments for changes and suspensions of work under subcontracts; and to decide disputes under the terms of both contracts.⁵¹ Consequently, the board concluded that not only may the subcontractor certify the claim in the case, but that he must do so.⁵²

The next case, A & B Foundry, Inc.,⁵³ involved the DOE Board of Contract Appeals' (EBCA) consideration of whether the board had the jurisdiction to hear a direct appeal by a

contractor who supplied goods to another contractor who was expressly acting as an agent of the government. Stated another way, was such a contractor a party to a government contract within the definition of the term "contractor" in the Act, so as to be afforded direct appeal rights under the Contract Disputes Act?

The board first concluded that the meaning of the term "contractor" in the act was ambiguous, and that the board could, therefore, refer to the Act's legislative history. In doing so, the board noted that at one time the proposed act defined the word "contractor" as follows:

. . . a party to a Government contract other than the Government; except that such term does not include any third party beneficiary or subcontractor. [Emphasis Added]⁵⁴

However this express language was not in the Act as finally written. This deletion, along with Congress' recognition that prior to passage of the Contract Disputes Act some agencies permitted direct appeals by subcontractors in certain instances,⁵⁵ led the board to conclude Congress did not intend to limit contractor appeals in agency cases to those which were sponsored by a prime contractor.⁵⁶ Thereafter, the board found that because the contractor had supplied goods to a private purchasing agent of the government, he was a "contractor" within the meaning of that term in the Contract Disputes Act.⁵⁷

Although this case only stands for the proposition stated above, there is a great deal of dicta in the opinion that implies that all instances whereby subcontractors gained direct access to the disputes resolution procedures of government contracts prior to passage of the Contract Disputes Act were sanctioned to continue after the Act's passage, even if there was no privity of contract between the government and the subcontractor. This broad interpretation has not been followed in subsequent decisions, and appears to be unjustified.⁵⁸

The next case to be discussed is Detroit Testing Laboratory, Inc.,⁵⁹ (DTL), which involved an appeal by DTL from a denial for equitable adjustment to a fixed price purchase order issued by General Electric Knolls Atomic Power Laboratory (KAPL), a cost-plus-fixed-fee prime contractor with the DOE. The board found, first of all, that it had jurisdiction to hear the case under the Contract Disputes Act, and secondly, that DTL was not entitled to an equitable adjustment.

.KAPL initially argued that there was no privity of contract between DTL and DOE, and therefore DTL could not bring an action directly against DOE under the Contract Disputes Act. This jurisdictional argument was based upon the following points: 1) DTL was not a "contractor" within the meaning of the Contract Disputes Act and its appeal wasn't sponsored by KAPL; 2) direct subcontractor actions against DOE were not

permitted in the absence of privity of contract; 3) DTL did not seek a decision from a DOE contracting officer; 4) specific language in the subcontract denied the existence of an agency relationship with DOE; and, 5) under the holding of United States v. New Mexico,⁶⁰ KAPL was not DOE's agent. This last argument will be addressed later.

It should be noted at this point that DTL's contract with KAPL included a disputes clause which required that disputed questions of fact between DTL and KAPL be decided by the DOE contracting officer with appeals to the EBCA. However, DTL's claim was submitted to, and denied by, the KAPL contract administrator. Therefore DOE's only direct involvement in the dispute was its review of KAPL's draft reply denying DTL's claim. This was later determined to be a constructive denial of DTL's claim because the DOE contracting officer knew of the claim and failed to issue a timely decision.

Unlike the A & B Foundry⁶¹ case, where the parties had stipulated to the existence of an agency relationship, the board was forced here to analyze the elements of KAPL's contract with DOE against the requirements for an agency relationship, as follows:

The fundamental elements of an agency relationship are the principal's right to control the agent's actions, e.g., Aetna Ins. Co. v. Glens Falls Ins. Co., 453 F.2d 687 (5th Cir. 1972), and the parties' mutual consent to the

relationship. See, e.g., Eitel v. Schmudlapp, 459 F.2d 609 (4th Cir. 1972). The latter element requires that the parties intend to function as principal and agent but not necessarily that they intend to create an agency relationship.⁶²

The board then analyzed the contractual relationship between DOE and KAPL and concluded that despite its expressions to the contrary, the prime contract gave DOE sufficient control over KAPL to create a principal-agent relationship. In particular the contract contained provisions which:

- 1) transfer title directly from the vendor to the Government;
- (2) establish a revolving fund for expenditures;
- (3) insure the Government's right to pay subcontractors directly;
- (4) provide for payment of a low fee to KAPL;
- (5) hold the Government liable for the risks of nuclear hazards;
- (6) require inclusion of standard clauses in subcontracts and purchase orders;
- (7) insure the Government's right to approve procurement arrangements; and give DOE control over KAPL's personnel.⁶³

All of these factors combined to give DOE a great deal of control over DTL's manner of performance, as opposed to the typical contractual relationship which is more concerned with the results of that performance. With that amount of control available to DOE, the Board correctly decided the agency issue despite the purported express denial of an agency relationship in the contract.

It had been mentioned earlier that one of the arguments offered against a finding of an agency relationship was the Supreme Court's holding in United States v. New Mexico.⁶⁴

This relates to another case involving a DOE plant manager, but only that case concerned the complicated issue of the ability of such a contractor to claim federal immunity from state sales and use taxes. There had been a series of cases involving this issue,⁶⁵ and these have added some confusion to this area of the law.

The United States v. New Mexico decision was the most recent of these cases, and in this opinion the Supreme Court closely examined the nature of the relationship between DOE and three private contractors who performed management, maintenance, and construction and repair services for DOE at three different government owned atomic laboratories in New Mexico. The Court concluded that these contractors were not so incorporated into the government structure as to make them instrumentalities of the United States and thus immune from state taxation.⁶⁶ This led the government to argue in later agency cases that the Court had ruled that such management contractors were not to be considered government agents for any purpose.

In the case of Arntz Contracting Company, A Joint Venture,⁶⁷ the EBCA squarely addressed this issue. The case involved a contractor who attempted to present a claim directly to the board under alternate theories. First, he argued that under the logic of the A & B Foundry decision he was a "contractor" within the meaning of the Contract Disputes Act.

As a second alternative, he argued that he was authorized to proceed directly against the government on the basis of the disputes clause in his subcontract.⁶⁸ The board concluded that the government would not be prejudiced by allowing the subcontractor to plead these alternate theories and postpone his election decision, but also ruled that the agency issue could not be determined without further development of a record.

Most importantly, however, the board rejected the government's argument that the New Mexico decision foreclosed the possibility that the board could find an agency relationship between the DOE facility operator and DOE. In doing so, the board stated:

For purposes of this decision, the Board agrees with Appellant's view that the New Mexico case is not dispositive of the issues raised in this appeal. Without attempting a detailed explanation, suffice it to say that New Mexico decided an issue of taxation as between the Federal and State Governments. It did not decide the issues relevant to whether the remedies provided by the Contract Disputes Act are available to a subcontractor if the prime contractor is, in fact, a purchasing agent of the Government.⁶⁹

This analysis appears to be correct because the Court in the New Mexico opinion emphasized that:

a finding of constitutional tax immunity requires something more than the invocation of traditional agency notions: to resist the State's taxing power, a private taxpayer must actually "stand in the Government's shoes." [citation omitted]⁷⁰

Consequently, when the government raised this argument again

in the DTL case, the board cited the Arntz decision and reiterated that the New Mexico case related to the issue of taxation between federal and state governments and not to the issue of determining privity of contract for purposes of deciding the availability of the disputes procedure to government contractors and subcontractors.

It can be seen from these cases that an agency relationship between the government and the prime contractor can serve to put a subcontractor in the shoes of the "contractor" for purposes of allowing the subcontractor direct appeal rights under the Contract Disputes Act. Such an agency relationship can be expressly set forth by the government and the prime contractor or can be found to have been impliedly created, despite express declarations to the contrary, when there is a contractual relationship which gives the government sufficient control over the contractor and his manner of performance.

Third-Party Beneficiaries

Government subcontractors have on occasion been able to gain recovery directly from the government on the theory that it was the intention of the parties to the government prime contract to confer an enforceable benefit upon the subcontractor. The theory has been described thusly:

A contract in which the promisor engages to the promisee to render some performance to a third person is generally called a contract for the benefit of a third person with little regard to whether the purpose of the promisee in entering into the contract was his own benefit or the benefit of the person to whom performance was to be rendered. This type of contract forms a widely recognized exception to the basic principle that only parties to a contract may enforce it.⁷¹

Because there has been a great deal of confusion in the application of this theory to contract law in general, the American Law Institute attempted to clarify matters in its discussion of the theory by dropping the traditional terms of "donee" and "creditor" beneficiary, and instead opted to utilize the terms "intended" beneficiary and "incidental" beneficiary. This, it was believed, would emphasize that the important inquiry was whether the promisor and promisee intended to create rights in the third party.⁷²

The leading government contracts case under this theory is United States v. Huff,⁷³ in which tenants on land leased by the owners to the Army for use as a training area were able to bring a suit under the Tucker Act for breach of contract even though they were not parties to the lease agreement. That agreement had certain provisions which allowed the Army to set down wire fences but which also required the Army to replace the fences following the crossing of the lands by troops. Additionally, the tenants, who were raising sheep on the lands, were permitted to

continue doing so under the lease. After certain negligent acts by the government allegedly caused loss and damage to the livestock, a suit for tortious breach of contract was brought against the United States. In defense, the government argued that there was no privity of contract between the tenants and the government, but the court found otherwise, stating that " . . . the Government lease is charged with obligation toward the tenants, that they are third-party beneficiaries of the contract, and that, therefore, they may sue upon it."⁷⁴

Another example where a subcontractor was successful in utilizing this theory occurred where he successfully claimed to be a third-party beneficiary of the government's promise to a cost reimbursable prime contractor to pay all unliquidated claims in the event of termination of the contract by the government.⁷⁵

This remedy has not been widely successful because the courts have traditionally looked closely at any purported third-party beneficiary agreement and have strictly construed its terms. Thus, in Deltec Corp. v. United States,⁷⁶ the Court of Claims refused to allow recovery to a supplier to a firm-fixed price subcontractor where the prime contract had a provision which made the prime contractor the government's agent when purchasing supplies approved by the contracting officer and which also provided

that each cost-plus-fixed-fee subcontract should provide that the subcontractor would act as the government's purchasing agent. The court concluded that although plaintiff would have been able to claim privity based upon agency principles if he had dealt with a cost-plus subcontractor, this argument was not available to him because he dealt with a fixed-price subcontractor. Nor could he claim to be a third-party beneficiary of the prime contract's provision making title pass directly from the vendor to the government when supplies were purchased because this provision was not intended to confer a benefit upon the supplier but was only intended to facilitate the duty-free entrance of supplies into Spain, where the prime contract was performed.

Similarly, in A & A Hardware, Inc. v. Samuel E. Pierce, Secretary of Department of Housing and Urban Development (HUD),⁷⁷ the court found that the supplier to a contractor who managed and maintained a project for HUD could not show that he was a third-party beneficiary of the cost reimbursable management contract between the contractor and HUD because he could not show that the contract was intended for his direct benefit and conferred enforceable rights on him.

Finally, in Fairchild Industries, Inc. v. United States,⁷⁸ a subcontractor was unable to bring suit against

the government on the theory that he was a third-party beneficiary of an assignment agreement which was entered into between the prime contractor and a bank because the government was not a party to the assignment agreement.

A recent case in the ASBCA has called into question the ability of a subcontractor third-party beneficiary to bring a claim under the disputes clause of the prime contract.⁷⁹ In this case a subcontractor for a prime contractor dealing with an Army Officer's Club⁸⁰ appealed the denial by the government's contracting officer of his claim for \$9000 which he believed the prime owed him. The RFP for the prime contract had indicated that the prime contractor would furnish a performance and a payment bond but the contracting officer agreed to an alternate arrangement. Under this, the prime furnished the government with a performance and payment bond from a subcontractor; an escrow agreement covering a \$75,000 escrow account; and he also assigned certain receivables due from the Army on other contracts. Toward the conclusion of the prime contractor's performance, the contracting officer released these funds, after which the subcontractor alleged that he was unable to recover the last \$9000 on his subcontract.

The subcontractor argued that he was a third-party beneficiary of the alternate bonding agreement between the government and the prime, and, as such, should be allowed to

bring a claim directly under the disputes clause of the prime contract. The board concluded that the disputes clause of the contract only provided that the "contractor" was entitled to appeal a contracting officer's decision and that even if the subcontractor was a third-party beneficiary of the bonding agreement, he would not be able to establish standing as the "contractor" within the meaning of the disputes clause.⁸¹

This decision could create confusion in this area unless it is strictly limited in its application to a claim based upon a disputes clause in a contract not subject to the Contract Disputes Act, because the board has distinguished the existence of privity of contract by virtue of the third-party beneficiary theory from the ability of the board to hear a claim based upon the contract's disputes clause. However, in a case in which the Contract Disputes Act is controlling, it would appear that earlier precedents allowing relief to a third-party beneficiary under the Tucker Act should control. Furthermore, a case under the Contract Disputes Act should be appealable before a board as a claim "relating to the contract" without regard to the particular wording of the disputes clause, because the act has extended the board's jurisdiction to breach of contract claims as well as claims based upon a remedy granting clause in the contract.

Direct Appeals by Subcontractors

As indicated earlier, there have been instances in the past where government agencies have specifically allowed subcontractors to have direct rights to a decision by the contracting officer with an appellate right to the agency's board of contract appeals.⁸² This occurred most frequently under the Atomic Energy Commission where the prime contractor was operating under a cost reimbursable contract and the subcontract had a disputes clause approved by the government which afforded direct appeal rights to the subcontractor. Under this process, it was recognized that the government was the real party in interest in the claim,⁸³ although there was no concession that the government and the subcontractor were in privity of contract.

Currently, the Department of Energy (successor to the Atomic Energy Commission) regulations and the Federal Procurement Regulations (FPR) are silent regarding agency authority to allow such appeals while the Defense Acquisition Regulations (DAR) and the proposed Federal Acquisition Regulations (FAR) express a policy against such clauses.⁸⁴ Consequently, it is questionable whether such clauses will be of much impact in providing relief to subcontractors in the future. Nevertheless, the existence of such clauses in current contracts, as well as the

possibility that they may not be absolutely barred from use in the future, justifies the consideration of two legal issues created by these clauses.

The first issue to be considered is whether the Contract Disputes Act has precluded the use of agency boards to decide such claims unless it is conceded at the outset by the agency that the subcontractor was in the shoes of the "contractor", under the definition of that term in the Act.⁸⁵ Stated another way, can it be claimed that the boards have authority to hear such claims beyond the authority conferred in the Contract Disputes Act?

The methods for administratively handling disputes in government contracts prior to the Act's passage were created by "executive branch fiat--that is, by the insertion of contract terms specifying how disputes in specific areas will be resolved--and by agency regulations governing the procedural and substantive adjudication of disputes."⁸⁶ The agency boards of contract appeals were appointed by and reported to the agency involved in the dispute.

Under this system, the appeals board acted as the delegated representative of the agency head to decide disputes arising under contracts entered into by the agency. Therefore, their authority to decide a particular dispute came not only from the terms of the particular disputes clause of the contract but also from the delegation

of authority from the agency head. With respect to this latter aspect of the board's authority, it is axiomatic that the board's authority could not be broader than the authority possessed by the agency head.⁸⁷

The question of authority under the disputes clause was easily resolved as long as the practice was not prohibited by regulation, the disputes clause in the subcontract gave the subcontractor direct access to the board, and that clause was approved by a government representative with proper authority. The issue regarding the agency head's authority to allow such appeals was most often resolved because these subcontract clauses were most frequently utilized in connection with cost reimbursable prime contracts. It was rationalized that the government's potential liability for payment of the claim made it the real party in interest and thereby justified the use of the government's administrative disputes resolution system.⁸⁸

When the Contract Disputes Act established a statutory basis for the existence of the boards of contract appeals,⁸⁹ with the express limitation in the Act that board members should have no other inconsistent duties,⁹⁰ the question arises whether it was Congress' intention to limit the boards' powers to those set forth expressly in the Act.

Prior to any consideration of this question, it must be

realized at the outset that Congress considered, and rejected, the notion that the power to create boards be taken from the agency heads and placed exclusively in the hands of the Administrator of Federal Procurement Policy.⁹¹ Thus, the choice was made to leave the ultimate authority over the boards in the hands of the agency heads. Nevertheless, the provisions of the Office of Federal Procurement Policy Act⁹² authorize the Administrator to issue guidelines with respect to criteria for the establishment, functions, and procedures of the agency boards, but the implementation of this authority does not, as yet, appear to preclude the use of boards to hear direct appeals.⁹³

The question has not been squarely addressed to date because the cases allowing direct appeals by subcontractors since the passage of the Contract Disputes Act were management cases which were resolved on the basis of agency principles.⁹⁴ However, in an analogous situation concerning a post-Contract Disputes Act, NAFI contract which was not included within those contracts made applicable to the Contract Disputes Act,⁹⁵ the ASBCA considered an appeal on the sole basis of the authority conferred upon it by the disputes clause in that contract.⁹⁶ Thus, at least this case indicated that the Contract Disputes Act was not the exclusive source of authority for the board to act.

Furthermore, since it would not appear that the consideration of such direct appeals by a board could be considered an "inconsistent duty,"⁹⁷ the authority appears to exist unless specifically precluded by OFPP or other appropriate agency regulation.

The second issue presented by direct appeal procedures is whether the contracting officer may agree to arbitrate disputes between the subcontractor and prime contractor when the government has no pecuniary interest in the outcome of the dispute. This question was raised by the ASBCA in TRW, Inc.,⁹⁸ where the board stated:

Even if we had found that the contracting officer committed himself to decide disputes under those circumstances, we probably would have to hold that any attempt to commit the Secretary to settle such disputes would be beyond the contracting officer's authority and, therefore, not binding on the Government. However, we did not reach this question.⁹⁹

In the TRW case, the board considered whether the government had been committed to decide a dispute between the subcontractor and the prime contractor, after the board had already concluded that the government would not be liable to the prime for any reimbursements regardless of the outcome of the dispute between the prime and his subcontractor. But, the board did not, ultimately, address the authority question because it concluded that the contracting officer had not agreed to decide such a dispute

because when he approved the subcontract and its disputes clause, he stated that the approval did not relieve the prime of his obligations under the prime contract and did not create any obligation for the government to the subcontractor. Consequently, the board reasoned that,

It does not follow that the contracting officer intended to agree to make available his and this Board's services to settle disputes in which the Government had no ultimate responsibility and, hence, no direct interest. On the contrary, we think that any agreement to render such services to prime and subcontractors is sufficiently outside the scope and intent of the prime contract between TRW and the Government to have required a more specific and detailed agreement than the mere approval of a subcontract.¹⁰⁰

As previously stated, the approval of such subcontracts has primarily been justified on the basis that the government was the real party in interest in the dispute and therefore authorized to commit agency resources to its resolution. In an analogous situation involving the ASBCA's consideration of disputes in which the government was not a party to the contract, the board justified hearing a dispute on a contract between a private contractor and the State of Georgia for the building of barracks for the National Guard, on the basis that the disputes clause had been specifically approved by the appropriate authority in the Army and the project was being federally funded.¹⁰¹

Federal funding, or the potential requirement for federal reimbursement if the claim is paid, has not been the

sole basis for finding authority to approve the use of the agency board where the agency is not in privity. For example, specific statutory authority for such involvement was found by the Corps of Engineers Board of Contract Appeals (ENG BCA) under the Intergovernmental Cooperation Act,¹⁰² when it indicated that it could decide disputes between a private contractor and the Washington Metropolitan Area Transit Authority (WMATA). The board noted that the Chief of Engineers had agreed to allow the board to do so if the WMATA reimbursed the Corps of Engineers for its costs.¹⁰³

Consequently, it can be seen that some basis for the authority derived from the agency head must be found to justify the board's acting on the appeal, and the language in TRW¹⁰⁴ would appear to indicate there would be a serious authority question if the board were to act in a matter where no potential liability existed on the government's part. It is suggested that if it were desired to provide such a service to the prime contractor and subcontractor, the contracting officer would be well advised to make a specific determination that providing the service was in the government's best interest because the availability of such a disputes resolution procedure in the subcontract will make the government's administration of the prime contract easier and more effective. This would, in

turn, improve the prime contractor's ability to perform under the prime contract. If possible, it would also be of benefit if the contracting officer were able to itemize the consideration the government received for making the service available.

Other Forms of Direct Relief

Tort Relief

In addition to the possible methods for subcontractors to obtain relief based upon contract theory, it should also be remembered that the United States, through the Federal Tort Claims Act (FTCA),¹⁰⁵ has also waived sovereign immunity for the negligent or wrongful act or omission of any employee of the government committed while acting within the scope of his office. Therefore, if the government action which caused injury to the subcontractor could be considered tortious in nature, this avenue of relief should be carefully explored. There is nothing in the act which would per se preclude the potential recovery by a subcontractor. In fact, the frequent government claim that the government and the subcontractor are not in privity of contract could inhibit another frequent claim made by the government in such actions that the plaintiff's claim was really a breach of contract claim which could not be heard in federal district court.¹⁰⁶

The first major requirement for obtaining relief under the FTCA is that it must be shown that the claim is based upon the wrongful or negligent act on the part of a government employee. This precludes relief based upon strict or absolute liability principles.¹⁰⁷ In this context, the case of In Re Bomb Disaster at Roseville California, on April 28,¹⁰⁸ provided a list of potential actions for subcontractors to consider, when the court explained the meaning of the word "wrongful" in the act as follows:

When faced with the question, the judiciary has generally ruled that the word "wrongful" was intended to include more than just negligent acts. Courts have found trespass, conversion, waste, and duress to be wrongful acts within the meaning of the FTCA.¹⁰⁹

For example, in Gardiner Manufacturing v. United States,¹¹⁰ a subcontractor brought an action against the United States for the cost of materials furnished to a government contractor for use on a government project. The materials were paid for by the prime contractor with a check which was subsequently dishonored, and the prime contractor also went bankrupt. After finding that the subcontractor could not bring an action against the government under the Tucker Act because there was no allegation of the existence of a contract between the subcontractor and the government,¹¹¹ the court considered an allegation of tortious conversion under the

FTCA. This was based upon a theory that the prime contractor acquired only voidable title to the property in question and the government could acquire no greater title than the prime contractor. Consequently, the subcontractor argued that when the government learned that the prime contractor's check was dishonored it had a duty to return the property, and its failure to do so resulted in the tort of conversion.¹¹²

The court rejected the subcontractor's argument on the basis that under the Uniform Commercial Code (UCC) a person with voidable title has the power to transfer good title to a good faith purchaser for value. However, the court did recognize the potential for bringing an action for conversion under the FTCA.¹¹³

Similarly, in the case of United States v. Georgia Marble,¹¹⁴ the court discussed the close relationship between the tort claim of conversion and the claim of breach of implied contract when the government takes a subcontractor's property. There the court stated that, "If the United States had taken possession of the marble under an asserted right or title and thereby violated the plaintiff's property rights, the cause of action would have been one sounding in tort for which the Tucker Act affords no remedy."¹¹⁵

Finally, as an interesting sidelight to the close relationship between conversion actions and actions based upon implied contract, the Supreme Court, in Hatzlachh

Supply Co., Inc. v. United States, ¹¹⁶ held that a suit under the Tucker Act alleging breach of implied bailment contract concerning the Customs Service's seizure of goods, was not barred by the exception to liability under the FTCA as to claims "arising in respect of . . . the detention of any goods or merchandise by any officer of customs."¹¹⁷ In rejecting the Court of Claims' analysis that it would not find an implied-in-fact contract because it could not "judicially allow by the back door a claim which was, rather clearly and explicitly, legislatively barred at the front,"¹¹⁸ the Court indicated that there was no indication in the FTCA or its legislative history, that the Act was intended in any way to limit already existing remedies under the Tucker Act¹¹⁹ for breach of contract. This is an important case to keep in mind when deciding between possible avenues of recovery because the FTCA also contains a number of other exceptions which are likely to be presented by the government as a bar to recovery.

The first, and perhaps most important of these exceptions involves the so-called "discretionary acts" exception, which exempts:

Any claim based upon . . . the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or any employee of the Government, whether or not the discretion involved be abused.¹²⁰

It can be expected that this exemption will be raised as a defense by the government whenever actions by government officials are alleged to have caused the harm, particularly with respect to the preparation and approval of government plans and specifications.¹²¹ Generally, liability will be determined on the basis of whether the alleged negligent act was performed at the "planning", or the operational level of the project.¹²²

Other exemptions which could be troublesome to the assertion of a tort claim by a subcontractor are the so-called "intentional tort" exemptions which most pertinently bar relief for torts based on misrepresentation, deceit, or interference with contract rights.¹²³ In particular, it can be expected that the government will argue that the claim is based upon misrepresentation or deceit whenever it involves a form of communication from the government to the claimant. The success of this assertion by the government is likely to be dependent upon whether the government's action was negligent but only incidentally involved communication versus the situation where the gravamen of the claim was the communication of misinformation.¹²⁴

Because of the existence of a contract between the subcontractor and prime contractor, it is likely that the government will counter any tort claim asserted against it

by a subcontractor with the defense that it is a "claim arising out of interference with contract rights." This exemption has been construed as only applying to the particular tort, "interference with contract rights," rather than any tort committed by persons sustaining contract relations.¹²⁵ However, the results may differ from jurisdiction to jurisdiction because the particular elements of the tort are decided under the law of the place where the act or omission occurred. For example, in New York, where the cause of action is based upon intentional and knowing interference for an unworthy or unselfish purpose,¹²⁶ a defense based upon this exemption might not be successful if the tortious injury complained of only alleged harm caused by negligent or wrongful conduct. In addition, although one case has indicated that the question might be open as to the applicability of the exemption to the tortious interference with prospective contractual relations,¹²⁷ it has been held in other jurisdictions that interference with prospective pecuniary advantage, or prospective contractual relations is encompassed within the exemption.¹²⁸ Consequently, it would appear that allegations along these lines should be avoided.

As alluded to already, the FTCA provides that the United States can be liable under the act if, under the law of the place where the act or omission occurred, a private person

would be liable to the claimant.¹²⁹ The application of the law of the place can also affect the decision whether to proceed under a tort theory or contract theory because a cause of action under the law of a particular state might not be available under the FTCA if that cause of action were based upon strict liability. For example, in the Gardiner Manufacturing case,¹³⁰ the court pointed out that even though conversion actions under the FTCA have been upheld in the Third Circuit, such an action might not be maintainable in that particular case because, under California law, conversion is a strict liability tort, and the FTCA requires that the cause of action be based upon the negligent or wrongful act of a government agent.¹³¹

In addition to the effect that the law of a particular jurisdiction may have upon the availability of this remedy, there are certain procedural requirements under the FTCA which must be met in order to assert a successful claim. First, the FTCA requires that an action may not be maintained for money damages until after the claimant has first presented his claim administratively before the appropriate federal agency and the claim has been finally denied, in writing, by certified or registered mail.¹³² In addition, the claim must be presented to the agency within two years of the date it accrued and these requirements have been construed as non-waivable

jurisdictional bars to suit under the Act. Consequently, if a suit were brought under the Contract Disputes Act alleging, for example, a tortious breach of an implied-in-fact contract, and it were subsequently determined that there was no such contract, an action under the FTCA would still have to meet these procedural requirements. If they have not been taken care of in sufficient time, the two year statute of limitations could bar recovery. Additionally, even if the administrative claim had been presented, the Claims Court would not be able to hear the case because FTCA cases must be brought in federal district court.¹³³

5th Amendment Taking

Closely related to the factual situation in the Georgia Marble¹³⁴ case, where the government took the property of a subcontractor, are those situations where it has been found that the government has taken property without just compensation in violation of the Fifth Amendment. For example, in the case of Armstrong v. United States,¹³⁵ the Supreme Court found that when the government, pursuant to its rights under the prime contract's default clause, took title to all finished and unfinished boats (the subject of the contract) and other unused materials, it destroyed the value of the subcontractor's rights to liens on that

property, and this destruction of the rights to these liens constituted an unconstitutional "taking" under the Fifth Amendment.¹³⁶ The close relationship between compensation under this theory and the type of taking involved in the Georgia Marble case, which was resolved under a breach of an implied-in-fact contract theory, has frequently made it difficult to distinguish between the two types of actions. Generally, however, if the government taking was not associated with its eminent domain powers as a sovereign, the use of the breach of an implied-in-fact contract theory would be more likely to be successful.¹³⁷

A recent case from the Court of Claims may help to define the boundaries of the unconstitutional taking logic. In Kearney & Trecker Corp. v. United States,¹³⁸ the subcontractor had a contract to manufacture and sell a complicated machining device to a government prime contractor. The delivery date for this contract was December 1981 and the contractor also had a contract to deliver a similar device to another private contractor in January 1982. When the government ordered the prime contractor to expedite the contract by issuing a priority directive under the Defense Production Act of 1950,¹³⁹ this acceleration caused the subcontractor to be unable to meet his private contract delivery date because he had to use that machine to meet the government's needs. The court

found no violation of the Fifth Amendment because the government compensated the subcontractor for the machine. In addition, the court indicated that while the taking of a contract could be the subject of a Fifth Amendment claim,¹⁴⁰ that only encompassed a direct, rather than consequential taking of a contract.¹⁴¹ In denying relief, the court stated:

The government did not appropriate the contract. The directive that required the plaintiff to expedite delivery of the Moduline to Lockheed merely frustrated performance of plaintiff's contract with Rolls Royce.¹⁴²

Assignments

Although subcontractors have been found to not be proper recipients of an assignment of a claim¹⁴³ under the Assignment of Claims Act,¹⁴⁴ it has been held that because the sole purpose of this statute is to protect the government, the government may waive its requirements. Thus, in one case it was found that the contracting officer consented to such an assignment contract,¹⁴⁵ and in such a situation the subcontractor could bring an action directly against the government to enforce the same rights to proceeds under the contract as the prime contractor had.

The case of G. L. Christian and Associates v. United States,¹⁴⁶ is an example where the government was found to have consented to an assignment of the contract to the

subcontractor. Here, the prime contractor was totally insulated from liability to the subcontractor so the subcontractor might have been prevented from any recovery had the court not recognized the government's consent.¹⁴⁷ But the court found, instead, that from the standpoint of fairness, the subcontractor should be recognized as the prime contractor since he had signed the contract on behalf of the prime, took over the entire role of prime contractor, and settled a large number of the cancellation claims directly with the government.

A final, and related area, where attempts have been made to recover directly from the government has occurred when a subcontractor has tried to enforce an "equitable lien" on contract retainages. Such retainages occur because as progress payments are paid by the government, they usually are related to the percentage of performance which has been completed. The amounts held back to account for uncompleted work are called retainages, and usually there is a percentage held back until final acceptance. Unpaid subcontractors will frequently notify the government that they have been unpaid, and claim an equitable lien on the amount of retainage the government still holds from the prime contractor.

In United States Fidelity & Guaranty Co. (U.S.F. & G.) v. United States,¹⁴⁸ certain subcontractors brought such an

action after they remained unpaid even after the prime contractor's Miller Act¹⁴⁹ surety had fully met his obligations. This can happen because the Miller Act bond normally covers only a portion of the entire contract price. The Court of Claims decided, en banc, that these subcontractors had no right to bring an action on their own behalf against the United States to recover from the retainages.

On the other hand, the 10th Circuit held, in Kennedy Electric Co. v. United States Postal Service,¹⁵⁰ that an electrical subcontractor who had performed on a building for the Post Office Department could bring suit against the Postal Service for its unpaid labor and materials because no Miller Act bonds had been posted. The court held that the subcontractor had an equitable lien on contract retainages and amounts which had been improperly paid to the prime contractor, and therefore rendered judgment in the subcontractor's favor.

The Court of Claims, thereafter, in United Electric Corporation v. United States,¹⁵¹ reconciled these apparently contradictory holdings when it considered a suit brought by a subcontractor against the United States for compensation due it under its government subcontract when both the prime contractor and the surety either failed or refused to make payment and the government had still

maintained retainages.

In considering the two previously discussed cases, the court noted that the U.S.F.&G. case was a suit against the United States under the Tucker Act, which required the breach of an express or implied-in-fact contract. On the other hand, the Kennedy Electric case was brought against the United States Postal Service under a statute in which the Postal Service was authorized to "sue or be sued" in its own name,¹⁵² which removed the requirement that the waiver of sovereign immunity under the Tucker Act be utilized. Thus, the court reasoned that the 10th Circuit was free to apply doctrines applicable to private persons and enforce the subcontractor's equities in the Kennedy Electric case.¹⁵³ Thereafter, the court reaffirmed the U.S.F.&G. holding and found that although the subcontractor might have certain equitable rights to contract retainages which might be superior to the rights of other persons to payment from such funds, those equitable rights do not provide an independent basis for suit under the Tucker Act.¹⁵⁴ This is also undoubtedly applicable to suits under the Contract Disputes Act.

As can be seen from the above, the area of assignments of rights and subrogation do not, except in certain unique factual circumstances, provide subcontractors any true additional basis for relief directly from the government.

Proceeding Through the Prime Contractor

Thus far the discussion has involved the various theories which may be used by a subcontractor to satisfy the privity requirement and obtain direct relief from the government. Generally, these can only be applied to particular situations where the facts justify their use. Thus, with the possible exception of the use of the implied agency theory in management contracts,¹⁵⁵ these theories are not likely to provide relief to a great many subcontractors. This section, however, will discuss the method for obtaining relief which is most often used by subcontractors, and which is the one preferred by government.¹⁵⁶ That is, the method whereby the prime contractor either sponsors the subcontractor's claim, or permits the subcontractor to use his name in processing the claim. Under either method, it will be referred to here as the "sponsorship approach."

The Nature of the Sponsorship Agreement

The sponsorship agreement is either set forth in a contract clause or merely manifested by the prime contractor's filing of the claim on the subcontractor's behalf and allowing the subcontractor to present it. Or, the prime contractor may merely allow the subcontractor to use his name.¹⁵⁷

Normally, the agreement is the result of a trade-off. The subcontractor generally needs to be sponsored in order to be able to recover against the government, and the prime contractor should generally recognize this need if there is any kind of reasonable relationship between the parties. However, the prime contractor also will want some control over the subcontractor's claims because a number of questionable claims submitted in his name will undoubtedly have a detrimental impact upon his relationship with the government. Finally, a prime contractor is likely to want some protection against having a determination made in a claim he sponsored for his subcontractor being used against him in subsequent litigation instituted against him by the subcontractor. This protection is usually provided by including an exculpatory clause in the sponsorship agreement, which typically limits the prime contractor's liability for government caused damages to the amount he is able to recover from the government on behalf of the subcontractor.

It should be noted that in the absence of any agreement to sponsor the subcontractor's claims, there appears to be no legally enforceable duty requiring the prime contractor to sponsor them.¹⁵⁸ On the other hand, if there is an agreement, it would be enforceable. Thus, where the prime contractor has consented in advance to allow the

subcontractor to appeal in his name, his attempted refusal to consent to such an appeal at a later date will not bar the appeal.¹⁵⁹

It should be noted at this point that the certification requirements of the Contract Disputes Act may have some effect upon the sponsorship of claims. In the Turner Construction Case,¹⁶⁰ and the Johnson Controls¹⁶¹ case, the issue of whether the subcontractor's certification was adequate arose but was not answered because in each case the board found that the claimant was entitled to appeal directly to the board because he had been dealing with the government's agent. In Johnson, the prime contractor/agent did not certify the claim because he felt that the so-called subcontractor was the only one who could logically and realistically certify the claim.

Although the issue was not resolved in those cases, it is likely that in a normal sponsorship case (as opposed to an agency situation) the boards and the Claims Court will insist upon the prime contractor's certification. In other matters, for example, the certification requirements have been strictly construed and found to be a jurisdictional prerequisite.¹⁶² Additionally, both the continuation of the sponsorship approach in the Contract Disputes Act and the inclusion of the certification requirements in the Act were decisions which shared a common purpose of reducing the number of the frivolous claims.

In addition to having the prime contractor's active sponsorship, or agreement to allow the use of his name, the subcontractor's appeal must be based upon a right of the prime contractor in the prime contract. This is because the government is not a party to the subcontract and cannot be held liable under its terms. Thus, in Robert E. McKee General Contractor Inc.,¹⁶³ the Veterans Administration Contract Appeals Board (VACAB) concluded that it had no jurisdiction to hear an appeal from the contracting officer's decision that a portion of the work was required under one section of the prime contract's specifications rather than another, thus making the subcontractor responsible for performing the work rather than the prime contractor. The board reasoned that because there was no dispute as to the requirement to actually perform the work under the prime contract, the only dispute was between the prime and subcontractor as to who would do the work, and this dispute was not within the board's jurisdiction as conferred by the prime contract's disputes clause.

Herring Electric Company, Inc.,¹⁶⁴ is another example of this principle where it was held that a subcontractor was unable to bring a claim through the prime contractor for an equitable adjustment under a government change order because the government and prime contractor had already agreed that the change would be at "no-cost" to the government. Thus,

the prime contractor had no basis for claiming an equitable adjustment and the subcontractor could not repudiate the agreement to which it was not a party.

Closely related to the situation where the prime contractor has no right to an equitable adjustment, are those situations where the prime contractor does not agree with the subcontractor's legal position but instead agrees with the government's position. This has most often arisen over contract interpretation disputes. For example, in a decision which was subsequently overruled, the General Services Board of Contract Appeals (GSBCA) dismissed a subcontractor's sponsored appeal for lack of jurisdiction because the dispute concerned the interpretation of the requirements of the prime contract and the prime contractor agreed with the government's interpretation. The board reasoned that since there was no disagreement between the government and the prime contractor, there was no dispute under the prime contract, and therefore no jurisdiction for the board to hear the appeal.¹⁶⁵

As was quickly apparent to the board, this decision had improperly equated the prime contractor's lack of agreement with the subcontractor's legal position with the lack of availability of a remedy under the prime contract. However, this situation was rectified by the GSBCA in the Hoffman Construction Co.¹⁶⁶ case.

In the Hoffman case, the dispute concerned the subcontractor's entitlement for additional costs for claimed extra work which both the prime contractor and the government agreed was required, without change, under the contract's specifications. In denying the government's motion to dismiss, which relied on the Holder case, the board said:

It is . . . our opinion that the Holder doctrine should not be maintained and the case is overruled. We hold that a dispute between a subcontractor and the Government when presented in compliance with the disputes procedure, will not be jurisdictionally barred by the apparent agreement of the prime contractor with the Government's position. As indicated in Willard-Brent Co., Inc., GSBICA 3651, 73-2 BCA ¶10,134, a prime's agreement with the Government's position in a dispute between its sub and the Government can be used as evidence of the reasonableness of the Government's interpretation.¹⁶⁷

Although the matter has not yet been resolved, it would be consistent with this opinion and the decision in TRW, Inc.,¹⁶⁸ that a prime contractor also be free to certify the subcontractor's claim, even if he disagreed with the subcontractor's legal position, so long as he believed the claim was "made in good faith and is not frivolous or a sham."¹⁶⁹ As the ASBCA stated,

All the prime contractor is doing by proceeding or permitting the subcontractor to proceed in its name is seeking an authoritative determination in the forum that might ultimately have to decide the issue anyway.¹⁷⁰

In the beginning of the discussion concerning the nature of the sponsorship agreement, it was pointed out that the prime contractor will seek some protection from being liable to the subcontractor in subsequent litigation. This protection usually takes the form of a clause which exculpates the prime contractor to some degree from liability for government caused damages. Although such clauses are commonly used, they must be drafted carefully because if they are too broad, they may actually preclude the sponsorship of the subcontractor's claim. This is the result of the decision in the case of Severin v. United States,¹⁷¹ which is the subject of the next section.

The "Severin Doctrine"

The case of Severin v. United States has attained great notoriety almost since the day it was decided, and has injected an element of difficulty to the sponsorship approach. It has, depending upon the commentator, had either great impact, or hardly no impact, upon the "justice" subcontractors receive when engaged in performing on government contracts.¹⁷²

The case involved a prime contractor who was performing construction work on a post office in Rochester, New York, and who employed a subcontractor to do some of the marble work on the building. Because of government fault, both the prime contractor and the subcontractor incurred delay

damages, although the prime's only totalled \$73 while the subcontractor's totalled over \$700.00. The government issued a change order extending the performance period for the prime contractor but did not award any compensation, so the prime contractor sued on behalf of himself and the subcontractor for breach of contract.

Despite finding that the government had breached the contract and caused the alleged damages, the court denied the contractor recovery on behalf of the subcontractor because the subcontract, which was in evidence, had exculpated the prime contractor from responsibility for any damage caused by the government or any other subcontractor. The court noted that the subcontractor was the real party in interest on the claim but because of the lack of privity of contract with the government and because the assignment of such claims is prohibited,¹⁷³ the subcontractor could not bring the action himself. Consequently, because the government's waiver of sovereign immunity for breach of contract did not encompass suits for nominal damages,¹⁷⁴ the prime contractor was unable to recover the amount lost to the subcontractor because he could not prove that he had suffered damages (because of the exculpatory clause). If, on the other hand, the prime contractor had become liable to the subcontractor, even if he had not yet paid the subcontractor such amounts, the court said that liability

might constitute actual damages which would allow a suit to be maintained by the prime contractor.

Thus, it appeared that the court had announced a standing rule whereby a prime contractor would have to prove his actual liability to the subcontractor for the damages claimed by the subcontractor in order to be able to bring a suit on behalf of the subcontractor against the government. This was ironic because it appeared to reverse a long standing practice of allowing such suits on the sole basis of government liability to the prime contractor, and because the necessity for the utilization of prime contractor's sponsorship was brought about by the government's insistence on not conceding direct access to subcontractors. Yet, it now appeared that the government might be able to escape liability for damages which it caused on the basis of an exculpatory clause in a contract to which it was not privy.¹⁷⁵

The potentially harsh effect of this doctrine was lessened greatly by the courts willingness to interpret exculpatory clauses between the prime contractor and subcontractor in such a way that unless the clause absolutely barred the liability of the prime contractor to the subcontractor, the Severin doctrine would not bar the action. For example, if the prime contractor's liability was conditioned upon his ability to recover from the

government, there was found to be an implied obligation to sponsor the claim and such conditional liability would satisfy the requirements of the Severin doctrine.¹⁷⁶ Similarly, a release executed between a prime contractor and subcontractor which expressly reserved pending claims which had been submitted by the subcontractor through the prime contractor, was sufficient to avoid the effect of the Severin doctrine.¹⁷⁷ Finally, whereas the doctrine initially appeared to require that the prime contractor affirmatively show damages by demonstrating that he was liable to the subcontractor for the amounts in question, the doctrine has evolved to one in which suit will be allowed even if the subcontractor has dismissed a suit against the prime so long as there was no complete release of liability,¹⁷⁸ or where the prime contractor has testified that he has a moral obligation to pay the subcontractor if he successfully recovers.¹⁷⁹ And, to bring the doctrine full cycle, the burden has shifted so that the government must demonstrate that the prime contractor bears no liability to the subcontractor.¹⁸⁰

At the same time that the effect of the Severin doctrine was being limited by the interpretation of exculpatory clauses and the shifting of the burden of proof, it was also being limited in its application to suits for breach of contract.¹⁸¹ As stated in James F. Seger v. United States:

The Severin rule where it is applicable produces harsh results. Where the provisions of the prime contract provide a mechanism that in a proper case can mitigate injury to the subcontractor, and such provisions are incorporated by reference in the subcontract, abstract legal doctrines of privity and exculpatory clauses do not control.¹⁸²

The rationale for this distinction apparently was that the prime contractor's right to recover an equitable adjustment derives from a remedy granting clause in his contract. This is only dependent upon his ability to demonstrate entitlement to the adjustment, and not upon whether he has in fact been damaged.¹⁸³ Thus, in recent cases, boards have considered sponsored appeals based upon a remedy granting clause of the contract even though the prime was not legally obligated to pay the subcontractor because the subcontractor owed him money,¹⁸⁴ or where the subcontractor had released the prime contractor from liability on the claim he was sponsoring.¹⁸⁵

From the foregoing it can be seen that the sponsorship approach to presenting subcontractor claims will be successful if the prime contractor presents the appeal on behalf of the subcontractor, agrees to allow the subcontractor to use his name in such an appeal, or merely ratifies such use, although passive acquiescence may not be possible if the certification requirements of the prime contract are applicable. If the claim is a breach of

contract claim, the Severin doctrine could be a bar if the government is able to demonstrate that the prime contractor has no liability for the damages to the subcontractor. If, on the other hand, the claim is for an equitable adjustment, it will not be barred by the Severin doctrine but it must be based upon the prime contractor's right to such an adjustment from the government under the prime contract. Although the prime contractor may not agree with the subcontractor's legal position, this fact, in and of itself, will not bar the claim as long as the prime contractor remains legally entitled to the adjustment. The next chapter will discuss the nature of the subcontractor's remedies against the prime contractors if the sponsorship approach is unavailable and he has also been unable to justify recovery directly from the government.

NOTES

¹Senate Select Committee on Small Business, Report on Operation and Effectiveness of Government Boards of Contract Appeals (Petrowitz Report), S. Doc. No. 99, 89th Cong., 2d. Sess. (1966).

²Id. at 160.

³28 U.S.C. §1346(a) and §1491.

⁴Merritt v. United States, 267 U.S. 338 (1925). See also Silverman v. United States, 679 F.2d 865 (Ct. Cl. 1982), which explained the rationale for this rule by quoting United Electric Corp. v. United States, 647 F.2d 1082, 1084 (Ct. Cl. 1981), as follows:

" . . . The controlling axiom is that the United States may be sued only to the extent that it allows its sovereign immunity to be waived. Through 28 U.S.C. §1491, the United States has consented to be sued for money damages in certain restricted circumstances, the only relevant one being on the basis of a contract (either express or implied-in-fact) between the United States and the claimant. In the absence of a direct contractual link (express or implied-in-fact), no enforceable contractual right against the United States exists, and therefore a subcontractor, in privity only with its private prime, cannot recover directly from the Government for amounts owed it by the prime.

⁵Contract Disputes Act of 1978, 41 U.S.C. §601 et seq.

⁶Gil Dunn Services, PSBCA 1077, 83-1 BCA ¶16,364 (1983).

⁷4 Report of the Commission on Government Procurement, 30-31 (1972).

⁸Study Group No. 4, Final Report To The Commission on Government Procurement: Remedies 109-125 (1972).

⁹See, Hiestand and Williamson, The Procurement Commission's Contract Remedies and Award Protest Recommendations: A View From The Inside, 42 Geo. Wash. L. Rev. 244, 244-246 (1974); Gantt, A Critique of the Disputes Resolution Recommendations, 42 Geo. Wash. L. Rev. 288, 297-298 (1974); and, Williamson, Subcontract Disputes and the Procurement Commissions, 8 Pub. Cont. Newsletter (1973).

¹⁰Sen. Rep. 95-1118, 95th Cong. 2d. Sess. (1978). See also, ABT Associates, Inc., DOTCAB 1059, 80-2 BCA ¶14,657 (1980); J.M.C. Mechanical, Inc., ASBCA 26,750, 82-2 BCA ¶15,878 (1982).

¹¹Continental Illinois Bank & Trust v. United States, 112 Ct. Cl. 563, 81 F. Supp. 596 (1949).

¹²Id. at 564, 565; 81 F. Supp. at 597. This holding was based upon the "Severin Doctrine" announced in the case of Severin v. United States, 99 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944). This doctrine creates special problems when the subcontractor is seeking relief through the prime contractor's sponsorship and will be discussed in greater depth later.

¹³Id. at 565, 566; 81 F. Supp. 597, 598. The following specifications, included verbatim in the opinion, were considered:

SEC. 28, SUBCONTRACTS:

1. (See Art. 26 of the Contract.)

The contractor shall not award any work to any subcontractor without prior written approval of the Contracting Officer, and the terms of all subcontracts shall be subject to the prior approval of the Contracting Officer.

2. The Contractor shall be as fully responsible to the Government for the acts and omissions of subcontractors and of persons either directly or indirectly employed by them, as he is for the acts and omissions of persons directly employed by him.

3. The Contractor shall cause appropriate provisions to be inserted in all subcontracts relative to the contractor by the terms of the General conditions and other Contract documents insofar as applicable to the work of subcontractors (particularly, without limitation, as provided in Art. 26 of the Contract), and to give the Contractor the same power as regards terminating any subcontract that the Government may exercise over the Contractor under any provisions of the Contract Documents (see particularly Art. 25 and 26 of the Contract and Sec. 41 of these General Conditions).

4. Nothing contained in the Contract Documents shall create any contractual relation between any subcontractor and the Government.

¹⁴Id. at 556; 81 F. Supp. 598.

¹⁵Nickel v. Pollia, 179 F.2d 160 (10th Cir. 1950).

¹⁶Baltimore & Ohio R.R. v. United States, 261 U.S. 592 (1923).

¹⁷Federal Crop Insurance Corporation v. Merrill, 332 U.S. 380 (1947); ABT Associates, Inc., DOTCAB 1059, 80-2 BCA ¶14,657 (1980).

¹⁸Porter v. United States, 204 Ct. Cl. 355, 496 F.2d 583 (1974); Algonac Manufacturing Co. v. United States, 192 Ct. Cl. 649, 428 F.2d 1241 (1970); Baltimore & Ohio R.R. v. United States, 261 U.S. 592 (1923); Silverman v. United States, 679 F.2d 865 (Ct. Cl. 1982).

¹⁹679 F.2d 865 (Ct. Cl. 1982).

²⁰Id. at 870, 871. Although there was confusion as to the number of transcripts the government agreed to purchase, the resolution of this question is not important to this discussion.

²¹106 F.2d 955 (5th Cir. 1931)

²²Id. at 956, 957.

²³Id.

²⁴Id.

25Id.

26The well established rule in government contracts is that the Court of Claims (now Claims Court) lacks jurisdiction over contracts implied-in-law. Merritt v. United States, 267 U.S. 338 (1925); Putnam Mills Corp. v. United States, 202 Ct. Cl. 1, 479 F.2d 1334 (1973); Porter v. United States, 204 Ct. Cl. 355, 496 F.2d 583 (1974); Aetna Casualty & Surety Co. v. United States, 655 F.2d 1047 (Ct. Cl. 1981). Additionally, there appeared to be no assertion of sovereign rights to open the possibility of a 5th Amendment taking claim and the Federal Tort Claims Act had not yet been enacted.

27703 F.2d 266 (7th Cir. 1983).

28Id. at 269.

29DOTCAB 1059, 80-2 BCA ¶14,657 (1980).

30Id. at 72,287.

31Id. at 72,288. Although it is not clear from the decision exactly what work had been accepted, it appears that the subcontractor was referring to the portion of the draft study which he had submitted separately on his own initiative even though the prime contract was still viable at that time.

32Id. at 72,291.

33Id.

34679 F.2d 865 (Ct. Cl. 1982).

35205 Ct. Cl. 854, 506 F.2d 1406 (unpub.) (1974).

36Id. at 855.

37Id.

38216 Ct. Cl. 238, 574 F.2d 508 (1978).

3931 U.S.C. §200. This section reads in pertinent part:

"(a) After August 26, 1954 no amount shall be recorded as an obligation of the Government unless it is supported by documentary evidence of

(1) a binding agreement in writing between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by law,...."

⁴⁰161 U.S. App. D.C. 140, 494 F.2d 1059, cert. denied 419 U.S. 1020 (1974).

⁴¹Narva Harris, 216 Ct. Cl. 238, 242; 574 F.2d at 510 (1978).

⁴²Id.

⁴³Id. at 244, 574 F.2d at 511.

⁴⁴Id. at 245, 574 F.2d at 511.

⁴⁵Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954).

⁴⁶See, Nash, Innovations in Federal Construction Contracting, 45 Geo. Wash. L. Rev. 309 (1977); Sneed, The Construction Manager's Liability, Construction Litigation 317 (1981); Hiestand and Florsheim, The AEC Management Concept, 29 Fed. B. J. 67 (1969).

⁴⁷Turner Construction Company, ASBCA 25,171, 81-1 BCA ¶15,070, aff'd on reconsideration, 81-2 BCA ¶15,186 (1981)

⁴⁸41 U.S.C. §605 requires that all claims of more than \$50,000 be certified by the contractor to the effect:

"...that the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable."

The act, at 41 U.S.C. §601(4) defines the term "contractor" as a party to a Government contract other than the Government.

⁴⁹Turner Construction Company, ASBCA 25,171, 81-1 BCA ¶15,070 at 74,531, aff'd on reconsideration, 81-2 BCA ¶15,186 (1981). See also, materials relating to legislative history of the Contract Disputes Act, supra notes 9 and 10.

⁵⁰Id. at 74,532.

⁵¹Id. at 74,533.

⁵²Id. See also Johnson Controls, Inc., ASBCA 25,714, 81-1 BCA ¶15,779 (1982).

⁵³EBCA 118-4-80, 81-1 BCA ¶15,160 (1981).

⁵⁴Id. at 75,003.

⁵⁵Particularly in the Atomic Energy Commission. See, e.g., Carpenter Steel Co., AEBCA 5-65, 65-1 BCA ¶4796 (1965); Lester Associates, Inc., AEBCA 6-65, 65-1 BCA ¶4808 (1965); Rutherford Construction Co., AEBCA 33-7-66, 67-1 BCA ¶6140 (1967); Westinghouse Electric Corp., AEBCA 68-2-70, 70-2 BCA ¶8436 (1970).

⁵⁶A&B Foundry, Inc., EBCA 118-4-80, 81-1 BCA ¶15,160 at 75,003 (1981).

⁵⁷Id. at 75,005.

⁵⁸The issue regarding the authority to grant subcontractors direct access to the disputes process will be addressed again later.

⁵⁹EBCA 153-1-81, 83-1 BCA ¶16,458 (1983).

⁶⁰455 U.S. 720 (1982).

⁶¹81-1 BCA ¶15,160 at 75,003.

⁶²Detroit Testing Laboratory, Inc., 83-1 BCA ¶16,458 at 81,860.

⁶³Id. at 81,863.

⁶⁴455 U.S. 720 (1982).

⁶⁵Kern-Limerick, Inc. v. Scurlock, 347 U.S. 110 (1954); United States v. Livingston, 179 F. Supp. 9 (E.D.S.C. 1959), aff'd per curiam, 364 U.S. 281 (1961); United States v. New Mexico 455 U.S. 720 (1982).

⁶⁶455 U.S. 720.

⁶⁷EBCA 187-12-81, 82-2 BCA ¶16,115 (1982).

⁶⁸DOE regulations permitted the insertion of a disputes clause in subcontracts issued under cost-plus prime contracts. Current DOE regulations, however, are silent regarding such authority.

⁶⁹Arntz Contracting Company, A Joint Venture, 82-2 BCA ¶16,115 at 79,999.

⁷⁰455 U.S. 720 at 736.

⁷¹2 Williston, Contracts, §347 (3d ed. 1959).

⁷²Restatement of the Law Second, Contracts 2d, §133.

⁷³165 F.2d 720 (5th Cir. 1948).

⁷⁴Id. at 723.

⁷⁵Maneely v. United States, 68 Ct. Cl. 623 (1929).

⁷⁶164 Ct. Cl. 432, 326 F.2d 1004 (1964).

⁷⁷29 Cont. Cas. Fed (CCH) ¶82,295 (D.D.C. 1982).

⁷⁸223 Ct. Cl. 315, 620 F.2d 807 (1980).

⁷⁹Color Corner, Ltd., ASBCA 26,683, 82-2 BCA ¶15,957 (1982).

⁸⁰Id. at 79,095. Although this entity is a nonappropriated fund instrumentality (NAFI), it is not part of the Exchange Service, which is the only NAFI that was included within the coverage of the Contract Disputes Act. See also, Swiff-Train Co. v. United States, 443 F.2d 1140 (5th Cir. 1971) for a pre-Contract Disputes Act decision affirming that contracts with NAFIs have not been included within the waiver of sovereign immunity under the Tucker Act.

⁸¹Id. at 79,096.

⁸²See cases set forth in note 55 above.

⁸³Id.

⁸⁴DAR §23-203, Disputes and Arbitration, reads in part:

"(a) Consent by the Contracting Officer to a sub-contract does not constitute approval of the terms and conditions of the subcontract.

Nevertheless, the contracting officer shall not consent to a provision in the subcontract purporting to give the subcontractor the right to obtain a direct decision of the contracting officer or the right of direct appeal to the Armed Services Board of Contract Appeals. The Government is entitled to the management services of the prime contractor in adjusting disputes between himself and his subcontractors. The contracting officer should act only in disputes arising under the prime contract, and then only with and through the prime contractor, even if a subcontractor is effected by the dispute between the Government and the prime contractor. The contracting officer shall not participate in disputes between a prime contractor and his subcontractors."

Similarly, the proposed FAR §44:203(b)(3) provides:

"(b) Contracting officers shall not consent to--
 . . .

(3) Subcontracts with provisions obligating the contracting officer to deal directly with the subcontractor.

8541 U.S.C. §601(4).

86Sen. Rep. 95-1118, supra note 10.

87TRW, INC., ASBCA 11,373, 68-2 BCA ¶7099 (1968). See also, materials noted in note 55 above.

88Id.

8941 U.S.C. §607.

90Id.

91Sen. Rep. 95-1118, supra note 86.

9241 U.S.C. §401.

93OFPP Policy Letter 79-2, June 26, 1979. See also, Cibinic and Nash, Government Contract Claims, 169 (1981).

94Turner Construction Company, ASBCA 25,171, 81-1 BCA ¶15,070 aff'd on reconsideration, 81-2 BCA ¶15,186 (1981); A&B

Foundry, Inc., EBCA 118-4-80, 81-1 BCA 15,160, ; Arntz Contracting Company, A Joint Venture, EBCA 187-12-81, 82-2 BCA ¶16,115 (1982); Detroit Testing Laboratory, Inc., EBCA 153-1-81, 83-1 BCA ¶16,458 (1983).

9541 U.S.C. §602.

96Color Corner, Ltd., ASBCA 26,683, 82-2 BCA 15,957 (1982).

9741 U.S.C. §607.

98ASBCA 11,373, 68-2 BCA ¶7099 (1968).

99Id. at 32,891.

100Id.

101Jordan Contracting Co., Inc., ASBCA 23,027, 79-1 BCA ¶13,681 (1979). See also, American International Constructions Inc., ENGBCA 3633, 3667, 77-2 BCA ¶12,606 (1977).

102p.L. 90-577, 82 Stat. 1098. This act provides statutory authority for federal departments and agencies to provide special or technical services to state and local units of government on a reimbursable basis.

103Control Data Corp., ENGBCA 3685, 78-1 BCA ¶13,094 (1978). See also R.L. Hines Associates, Inc., DOTCAB 1001, 79-1 BCA ¶13,780 (1979).

104TRW, INC., ASBCA 11,373, 68-2 BCA ¶7099 at 32,891.

10528 U.S.C. §§1346(b), 2671 et seq. For a detailed discussion of the availability Federal Tort Claims Act relief to government contractors, see 2 Nash and Cibinic, Federal Procurement Law, Ch. 27 §2 and Ch. 31 §5 (3d ed. 1980).

106Woodbury v. United States, 313 F.2d 291 (9th Cir. 1963); Martin v. United States, 649 F.2d 701 (9th Cir. 1981); Aleutco Corp. v. United States, 244 F.2d 674 (3rd Cir. 1957); see also, Walsh v. United States, 672 F.2d 746 (9th Cir. 1982), where, in an action by landowners against the United States as the purchaser of a highway easement, alleging negligent damage to their livestock, the government claimed that this was an action based upon breach of an implied-in-fact contract, rather than a tort claim, and that it should be dismissed because the district court had no jurisdiction over such claims.

107 Dalehite v. United States, 351 U.S. 15 (1953); Laird v. Nelms, 406 U.S. 797 (1972); see also, Nash and Cibinic, supra note 105.

108 438 F. Supp. 769 (E.D. Cal. 1977).

109 Id. at 778.

110 479 F.2d 39 (9th Cir. 1973).

111 Id. at 40.

112 Id.

113 Id.

114 106 F.2d 955 (5th Cir. 1931).

115 Id.

116 444 U.S. 460 (1980).

117 Id. at 462; see also, 28 U.S.C. §2680(c).

118 Id.

119 Id. at 465.

120 28 U.S.C. §2680(c).

121 Nash and Cibinic, supra note 105 at 1860.

122 Id. at 1882-1886.

123 28 U.S.C. §2680(h).

124 Nash and Cibinic, supra note 105 at 1886-1887.

125 Nicholson v. United States, 177 F.2d 768 (5th Cir. 1949). This tort, as described in Prosser, Handbook of the Law of Torts, §129 (4th ed. 1971), is an intentional interference with the existing contractual relations of another.

126 Hendry v. United States, 280 F. Supp. 27, 33 (S.D.N.Y. 1968), aff'd, 418 F.2d 744, 749 (2d Cir. 1969).

127 Myers & Myers, Inc. v. United States Postal Service, 527 F.2d 1252, n.8 1260 (2d Cir. 1975).

128 Dupree v. United States, 264 F.2d 140 (3rd Cir.),
cert. denied 361 U.S. 823, reh. denied 361 U.S. 921 (1959);
Taxay, M.D. v. United States, 345 F. Supp. 1284 (D.D.C. 1972);
see also 5 A.L.R. 4th 9, 21n.

129 28 U.S.C. §1346(b).

130 479 F.2d 39 (9th Cir. 1973).

131 Id. at 40.

132 28 U.S.C. §2675(a).

133 Nash and Cibinic, supra note 105 at 2230.

134 106 F.2d 955 (5th Cir. 1931).

135 364 U.S. 40 (1960); see also, Quinn, Government Subcontractors' Remedies in Rem, 30 Geo. Wash. L. Rev. 994 (1962), for a discussion of this decision and other aspects of the rule that no liens may attach to government property.

136 Id.

137 See Nash and Cibinic, supra note 105 at 2158-2159.

138 688 F.2d 780 (Ct. Cl. 1982).

139 50 U.S.C. App. §2061 et seq.

140 Kearney & Trecker, 688 F.2d 780, 783, citing Brooks-Scanlon Corp. v. United States, 265 U.S. 106 (1924).

141 Id., citing Omnia Corp. v. United States, 261 U.S. 502 (1923).

142 Id.

143 Beaconwear Clothing Co. v. United States, 174 Ct. Cl. 40, 355 F.2d 583 (1966).

144 31 U.S.C. §203.

145 Tufto Corp. v. United States, 614 F.2d 740 (Ct. Cl. 1980); see also, Nash and Cibinic, supra note 105 at 1965-1967.

146 160 Ct. Cl. 1, 312 F.2d 418, reh. 160 Ct. Cl. 58, 320 F.2d 345, cert. denied 375 U.S. 954 (1963), 170 Ct. Cl. 902, cert. denied 382 U.S. 821 (1965).

¹⁴⁷The "Severin Doctrine" generally provides that a prime contractor may not sponsor a subcontractor's claim against the government if he is not actually liable to the subcontractor for those damages. This will be discussed in greater detail later.

¹⁴⁸201 Ct. Cl. 1, 475 F.2d 1377 (1973).

¹⁴⁹40 U.S.C. §270a-e, which requires that certain construction contractors provide performance and payment bonds to protect the rights of the United States, as well as those who work on the contract.

¹⁵⁰508 F.2d 954 (10th Cir. 1974).

¹⁵¹647 F.2d 1082 (Ct. Cl. 1981).

¹⁵²39 U.S.C. §401.

¹⁵³United Electric, 647 F.2d 1082, 1084.

¹⁵⁴Id. at 1086.

¹⁵⁵See Nash, Innovations in Federal Construction Contracting, supra note 46, for a discussion of the possible increase in the use of construction managers in government construction projects. Additionally, the increasing implementation of OMB Circular A-76 may also provide a basis for application of the express or implied agency doctrine.

¹⁵⁶Sen. Rep. 95-1118, supra note 10, and DAR §23-203, supra note 84.

¹⁵⁷See Nash and Cibinic, supra note 105 at 2062. See also, James Thompson & Sons, Inc., AGBCA 78-103, 79-1 BCA ¶13,748 (1979), which allowed an appeal where the subcontractor signed the appeal complaint but the prime contractor filed it. Compare, Hamilton & Voeller, Inc. AGBCA 79-137, 79-2 BCA ¶13,992, where the board did not allow an appeal because the prime contractor had not presented the appeal, and had not authorized or ratified it. The board rejected the argument that it was sufficient for the prime contractor to have sent a letter to the contracting officer notifying him of a potential claim he received from the subcontractor.

¹⁵⁸Clifton D. Mayhew, Inc. v. Blake Construction Co., 482 F.2d 1260 (4th Cir. 1973).

¹⁵⁹Westinghouse Electric Corporation, ASBCA 25,685, 82-2 BCA ¶15,960 (1982).

¹⁶⁰ASBCA 25,177, 81-1 BCA ¶15,070, aff'd on reconsideration 81-2 BCA ¶15,185 (1981).

¹⁶¹ASBCA 25,714, 82-1 BCA ¶15,779 (1982).

¹⁶²Harnischfeger Corp., ASBCA 23,918, 24,733, 80-2 BCA ¶14,541 (1980); Newell Clothing Co., ASBCA 24,482, 80-2 BCA ¶14,774 (1980); Paul E. Lehman, Inc. v. United States, 29 Cont. Cas. Fed. (CCH) ¶82,266 (Ct. Cl. 1982)

¹⁶³VACAB 742, 68-1 BCA ¶6966 (1968).

¹⁶⁴ASBCA 21,589, 79-1 BCA ¶13,775 (1979).

¹⁶⁵Holder Construction Co., GSBGA 1913, 67-2 BCA ¶6397 (1967), aff'd 68-1 BCA ¶7072 (1968).

¹⁶⁶Hoffman Construction Co., GSBGA 4306, 79-1 BCA ¶13,565 (1979).

¹⁶⁷Id. at 66,447.

¹⁶⁸ASBCA 11,373, 66-2 BCA ¶5882 (1966).

¹⁶⁹Id. at 27,296.

¹⁷⁰Id.

¹⁷¹99 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944).

¹⁷²See, for example, Note, A Plea for Abolition of the Severin Doctrine, 34 Geo. Wash. Law Rev. 746 (1966), which argues that the doctrine has led to irrational results and guess work involving potential recovery by subcontractors. On the other hand, Hubbard, The Severin Doctrine, 10 Mil Law Rev. 191 (1960), argues that the doctrine is only a rule requiring the prime contractor to prove damage, and nothing more. As will be seen, regardless of the initial rule of law set forth in the case, it has evolved into something far different.

¹⁷³31 U.S.C. §203.

¹⁷⁴Severin, 99 Ct. Cl. 435, 443.

¹⁷⁵See Chief Judge Whaley's dissent in the Severin opinion.

¹⁷⁶For example, in Donovan Construction Co. v. United States, 138 Ct. Cl. 97, 149 F. Supp. 900, cert. denied 355 U.S. 826 (1957), the court permitted the prime contractor to sponsor the subcontractor's suit despite an exculpatory clause in the subcontract which treated the claim as extra work and provided that the contractor would pay the subcontractor "as and when it is paid by the government."

¹⁷⁷Owens-Corning Fiberglass Corp. v. United States, 190 Ct. Cl. 211, 419 F.2d 439 (1969).

¹⁷⁸Cross Construction Co. v. United States, Ct. Cl. Order (19 Sept. 1980), 22 Gov't Contr. ¶424 (1980).

¹⁷⁹Timber Investors, Inc. v. United States, 218 Ct. Cl. 408, 587 F.2d 472 (1978); Bohemia, Inc., ASBCA 82-242-3, 83-1 BCA ¶16,157 (1982).

¹⁸⁰Morrison-Knudsen Co. v. United States, 184 Ct. Cl. 661, 703, 397 F.2d 826, 852 (1968); John McShain, Inc. v. United States, 188 Ct. Cl. 830, 412 F.2d 1281 (1969).

¹⁸¹Blount Bros. Construction Co. v. United States, 172 Ct. Cl. 1, 348 F.2d 471 (1965); Morrison-Knudsen Co. v. United States, 184 Ct. Cl. 661, 397 F.2d 826 (1968).

¹⁸²199 Ct. Cl. 766, 780, 469 F.2d 292, 300 (1972).

¹⁸³See Morrison-Knudsen, 184 Ct. Cl. 661, 397 F.2d 826. Although it should be noted that a somewhat different rationale for the distinction was offered in James v. Seger v. United States. That case concentrated more on the lack of a need for an exculpatory clause if the prime contractor was entitled to relief under a remedy granting clause.

¹⁸⁴F.E. Constructor, ASBCA 25, 784, 82-2 BCA 15,780 (1982).

¹⁸⁵CWC, Inc., ASBCA 26,432, 82-2 BCA 15,907 (1982).

CHAPTER II

RECOVERY FROM THE PRIME CONTRACTOR

If the subcontractor is unable to recover from the government for damages caused by governmental actions, his next alternative is to seek recovery directly from the prime contractor. His choices of possible forums for such relief include state court, federal district court if the jurisdictional requirements can be met, or arbitration. This latter alternative has grown in importance over the years as the parties have sought simpler and more efficient methods of resolving their contract disputes.¹

The subcontractor should have all of the traditional common law causes of action available to effectuate that recovery. First, he should be able to recover breach of contract damages if the prime contractor has failed to perform an express or implied duty of the subcontract. Secondly, he should have the option of seeking restitutionary relief if the prime contractor's breach was total,² or if the breach resulted in the prime contractor being unjustly enriched at the subcontractor's expense.³

Thirdly, the subcontractor should be able to recover through the use of any clauses in the subcontract which promise an equitable adjustment to the subcontract price and/or time of performance upon the occurrence of certain acts or events.⁴ Finally, certain government subcontractors have been furnished with an additional statutory remedy of attempting to recover from the Miller Act payment bond surety.⁵ This particular remedy will be discussed in the next chapter.

It is not the intention of this author to recommend specific contract clauses which are designed either to assist or prevent a subcontractor from being able to recover from the prime contractor for harm caused by the government.⁶ Instead, since most government subcontracts incorporate the terms of the prime contract, it is the intention here to analyze the litigation to determine who bears the risk for government caused harm in that context. In addition, in those cases where the prime contractor has attempted to exculpate himself from this risk, either totally as in Severin v. United States,⁷ or partially as in Donovan Construction Co. v. United States,⁸ the discussion will include a consideration of the validity of such exculpatory clauses.

In the situation where the subcontract has incorporated the terms of the prime contract, the rule should be that if

the government action involved a situation where the prime contractor was entitled to an equitable adjustment, then this entitlement should also flow-through to the subcontractor. Similarly, if the subcontract was breached in some way, and that breach was the government's fault, then that fault should also flow-through the prime contractor. This should allow the subcontractor to recover breach of contract damages from the prime contractor if, for example, the subcontractor incurred unreasonable delays because of a government fault. Finally, if the government has assumed the risk for damages which were not caused by anyone, then that protection should also flow-through the prime contractor and protect the subcontractor. Thus if additional expenses and delays arise because of differing site conditions, the right to an equitable adjustment should be available to both the prime contractor and the subcontractor. Unfortunately, the cases have not always agreed with the above propositions, and this has introduced an unnecessary degree of uncertainty to this area.

This chapter will look at the cases, first of all, from the standpoint of whether the government action has an effect on an express or implied promise from the prime contractor to the subcontractor. This would also include promised rights to equitable adjustments which flow through the prime contractor to the subcontractor. Secondly, the

chapter will look at the effect an exculpatory clause may have on the litigation and the rights and duties of the parties. The third subsection will deal with whether there is any duty on the part of the prime contractor to protect the subcontractor's interests before the government. Finally, the chapter will briefly examine the applicable rules concerning the applicable law for litigation between the prime contractor and subcontractor, as well as the rules regarding exhaustion of remedies.

Express and Implied Contractual Promises

If the prime contractor has expressly promised to do something for the subcontractor, and that promise has been supported by consideration, then it should be clear that the prime contractor will be liable to the subcontractor for any damages caused by a breach of that promise. For example, in Westinghouse Electric Corp. v. Garrett Corp.⁹ it was held that the prime contractor's failure to provide certain drawings to the subcontractor which were necessary for the subcontractor to perform satisfactorily constituted a breach of contract which made the prime contractor's default termination of the subcontract improper.

Although the prime contractor's failure to supply the drawings was not caused by government action in the Westinghouse case, there is no reason to expect a different

result merely because the failure was traceable to government fault, unless the subcontract had expressly excused the prime contractor from such liability. In the case of George A. Fuller Co. v. United States,¹⁰ a construction contractor was able to recover breach of contract damages from the government for himself and his subcontractors because the government failed to provide, in a timely manner, certain plaster models which were needed by the contractors to complete their work. The failure caused delays which resulted in the damages which were recovered.

There are other types of express promises made by prime contractors which will be enforced despite government action which is not in agreement. For example, in Construction Services Inc. v. Marty's Floor Covering Co.,¹¹ it was held that when a prime contractor and his fixed price subcontractor had agreed to a price for the subcontractor's extra night work which had been ordered by the prime contractor, that agreement was binding between the parties even though the government only allowed the prime contractor a lesser amount in his claim for equitable adjustment. The court correctly reasoned that the parties had entered into an enforceable agreement for the night work and the government could not set that agreement aside.

Another example where the courts will enforce an express promise by the prime contractor occurs when the

subcontractor agrees to perform government ordered changes in the work in exchange for an equitable adjustment to the subcontract. This is normally the result when the prime contract has been incorporated by reference into the subcontract. If the parties are unable to arrive at an agreement concerning the amount of this equitable adjustment, and they have not agreed to resolve the dispute through an administrative proceeding, the courts will enforce the promise and also determine an appropriate equitable adjustment.¹² This will be done even though the prime contractor is bound to pursue his equitable adjustment from the government through the prime contract's disputes clause. Furthermore, it has also been held that if the prime contractor has not followed the proper contractual procedures for issuing a change order, and has not given the subcontractor assurances that he will receive an appropriate equitable adjustment, this could be a breach of contract.¹³

One area in which the courts have been fairly uniform in their treatment of the obligations between the prime contractor and the subcontractor concerns the promise of payment. It is generally held that the prime contractor normally assumes the risk that the owner will pay for the work as required. As a follow on, the courts will not normally allow the prime contractor to shift this risk to the subcontractor by conditioning the subcontractor's right

to payment upon the prime contractor's receipt of payment from the owner. For example, in The Thos. J. Dyer Company v. Bishop International Engineering Company and General Insurance Company of America¹⁴ it was held that a contract provision which indicated that the subcontractor's payment was not due until five days after the owner had paid the prime contractor did not amount to a conditional promise to pay the subcontractor when and if the owner paid. It only amounted to an unconditional promise to pay with the time of payment postponed until the owner paid or for a reasonable period of time.

As stated previously, the rationale for such decisions is that the prime contractor normally assumes the risk of the owner's insolvency and the courts are unwilling to transfer this risk unless the parties have expressly indicated a desire to do so. Of course, this logic will not guarantee the subcontractor a right to receive payment if he has not performed satisfactorily or has not complied with other conditions precedent to his right to be paid.

An area which has involved a great deal of litigation between subcontractors and prime contractors has involved the issue of delay damages incurred by the subcontractor because of government action. The question centers on whether such delays constitute a breach of the prime contractor's implied duty to not hinder or delay the

subcontractor's performance. Such delays can arise because of defective specifications, government issued change orders, delays attributed to inspections, and delays caused by differing site conditions. It is noted that this latter category does not always involve government fault but it is included for purposes of this discussion because it is a cause for which the government has assumed the risk in the prime contract and it also is similar to the other categories because it does not involve the prime contractor's fault.

The basic rule concerning the implied obligation to not hinder or delay is as follows:

A contracting party impliedly obligates himself to cooperate in the performance of his contract and the law will not permit him to take advantage of an obstacle to performance which he had created or which lies within his power to remove.¹⁵

A second aspect of this rule is stated in this manner:

...When the obligation of performance by one party to a contract presupposes the doing of another act by the other party thereto, there arises an implied obligation of the second party to do the act which the performance of the contract necessarily involves.¹⁶

In construction contracts, these implied obligations are particularly important because the prime contractor normally has the responsibility to coordinate the work of a number of subcontractors, and to insure that the site is ready when needed by each of the subcontractors. Generally, he must

insure that the work proceeds without undue delay.¹⁷

Although the existence of these duties appears to be well settled, the issue is not so well settled as to whether the prime contractor is held to a breach of these duties if the subcontractor's work is disrupted and delayed by the government.

In the case of McDaniel v. Ashton-Mardian,¹⁸ a subcontractor brought a breach of contract suit against his prime contractor, as well as a Miller Act suit¹⁹ against the surety, claiming that he suffered consequential damages caused by a delay in his performance brought about by numerous government change orders. At issue was a total delay of one-hundred-ninety-six days which, for purposes of the decision, were totally attributed to the government change orders. There were a total of thirty-nine of these orders, but only three authorized any extension in the time of performance, and only one granted an equitable adjustment to the subcontract price.

It is important to note that the changes clause used in the contracts in this case was the pre-1967 Construction Changes Clause.²⁰ This clause only provided for an equitable adjustment to the contract price if the price change was caused directly by the changes. In construing this clause in the case of United States v. Rice,²¹ the Supreme Court had already decided that consequential damages

were not an appropriate element of the equitable adjustment available under this clause.

In McDaniel v. Ashton-Mardian, the subcontractor argued that the terms of the subcontract should be interpreted to allow for the inclusion of consequential delay damages which were caused by the change orders. However, the court concluded that such an interpretation would be inequitable because the prime contractor had no right to obtain the same relief from the government.²² The court reasoned that nothing in the subcontract had expressly or impliedly indicated that the subcontractor would be able to complete his work within a specific period of time. Because of the absence of such a warranty, the court stated:

When the party causing the delay is the United States Government and the contract is the standard government contract, it is impossible in the face of the precedents which we have cited, to find an equitable reason why a prime contractor without fault and without option and without right of reimbursement from the government, should have to compensate his subcontractor for damages resulting from delayed performance.²³

Another theory of liability was also advanced by the subcontractor. This theory appeared to be based in tort, because the subcontractor alleged that the prime was at fault when he accepted the government change orders. The subcontractor believed that these were cardinal changes, or changes which were not within the scope of the changes

clause. He argued that if the prime contractor had not accepted these changes, he would have been able to sue the government for breach of contract and would have been able to recover consequential damages in the suit. However, the acceptance of the change orders precluded such a recovery from the government.

Although the court did not find the prime contractor liable under this theory, it did not reject the argument offered by the subcontractor. Instead, the court found that these were not cardinal changes and therefore the prime contractor was not negligent in accepting them. This at least implied that the prime contractor did have a duty to protect the subcontractor's interests, a theory of possible recovery which will be examined again later.

The result of the McDaniel v. Ashton-Mardian case appears to be correct, at least for the time in which it was rendered. However, its precedential value should be examined carefully in light of the way the standard construction changes clause has been re-written. The subcontract had no provisions expressly making the prime contractor responsible for delay caused by the government, and the delay was not caused by the prime contractor's fault. He had not promised that the work would be done by a specified time, and the subcontractor knew that the government had the right to make certain changes.

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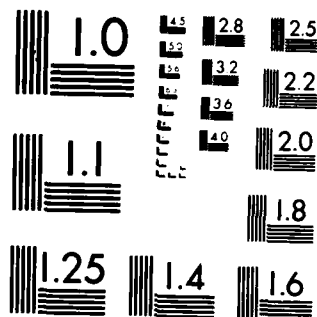
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The decision also follows the rule announced in McGrath v. Electrical Construction Company,²⁴ another delay case where the subcontractor's damages were caused by a government agent over whom the prime contractor had no control. The court held that although the prime contractor is generally liable to the subcontractor for losses caused by delays which were not the subcontractor's fault:

This rule, however, is applied against the contractor in situations where the responsibility may be placed on the contractor either because he might have prevented the delay or because the contract was not so phrased as to permit the inference of an intention that responsibility should rest elsewhere.²⁵

Perhaps the most important reason for concluding that this decision was correct is that the prime contractor was not in any better position than the subcontractor to recover the delay damages. Therefore, it could not be argued that the prime contractor was unjustly enriched because he was in a position to recover for consequential damages caused by the government while those damages were actually suffered by the subcontractor. If anything, the case appears to support the argument that the prime contractor's liability to the subcontractor should be interpreted in a manner which is consistent with the government's liability to the prime contractor. This would currently lead to a result which is quite different than the holding of the case.

Another more recent decision which appears to follow the

McDaniel v. Ashton-Mardian decision is Burgess Construction Company v. M. Morrin & Son Company, Inc.²⁶ This case held that the prime contractor's failure to make the site available by a particular date was not a breach of his implied duty to not hinder the subcontractor. The subcontractor had argued that he had suffered excessive delay damages but the court found no breach of contract because there was no warranty of site availability. In the absence of such a warranty, the court found no breach of contract because:

Breach of an implied promise not to hinder or delay the other party's performance is not established merely by proving there was a delay. The delay must be unnecessary, unreasonable or due to the defendant's fault.²⁷

This brief statement may be applied generally to the question of the prime contractor's liability for damages caused by government action. That is, unless the subcontractor can justify recovery on the basis of a restitutionary theory, the prime should not be liable unless: 1) he agreed to make an equitable adjustment; 2) he warranted against the events which caused the damages; or, 3) he had a duty to prevent the damages, or the events which caused the damages were unnecessary or unreasonable.

The case of W. Wright, Inc. v. Korshoj Corporation²⁸ illustrates how this rule can result in harsh results if the possibility of restitutionary relief is not adequately

considered. Although this case involved delay damages caused by differing site conditions rather than government action, it is analogous because the delay was not caused by the prime contractor's fault.

In the case Korshoj, the prime contractor was engaged in a government construction project, and subcontracted with Wright for certain mechanical work. The subcontract was bound by the terms and conditions of the prime contract, including the changes clause. However, it did not contain a separate clause promising a remedy if the project was delayed. The prime contract, on the other hand did promise an equitable adjustment to the prime contractor if changed site conditions caused an increase in cost or time required for performance of the contract.

The subcontractor's work on the contract was such that he could not begin until after the prime contractor had completed building the concrete shells for the construction. Therefore, when the prime contractor's completion of this task was delayed for a period of time by differing site conditions and the consequent contract modifications, the subcontractor was also delayed on equal period of time. Because of the contract modifications, the prime contractor received an equitable adjustment for his increased expenses which included an increase in his supervisory and overhead expenses caused by the delays.

After learning that Korshoj was negotiating an equitable adjustment, Wright advised him that he also wanted to be compensated for his delay damages. The prime negotiated his own claim separately and after he concluded those negotiations, he offered to submit the subcontractor's claim. When he attempted to present the subcontractor's claim to the government, he was advised by the government that it was too late because the other negotiations were complete. As a result, Wright sued Korshoj for the delay damages. The trial court granted judgment in favor of Wright and Korshoj appealed.

The Nebraska Supreme Court reversed the trial court and ruled that because the delay was caused by changed site conditions rather than any act on the part of Korshoj, it did not result in a breach of contract by him. The court reasoned that he had not promised access to the site by a specified date and although it was understood that the subcontract would be completed within a specified period of time after Korshoj received his notice to proceed, the subcontract was also made subject to any changes directed by the government. From this, the court concluded that the parties understood that the time necessary for completion was somewhat flexible. Consequently, since Korshoj was not at fault and there was no breach of an express promise, the court found that Korshoj was not liable for Wright's delay damages.²⁹

Although the rationale for the decision may not be faulted from the standpoint of the actual causes of the delay, the court's failure to grant relief to the subcontractor under a restitutionary theory appears to be unduly harsh. When the court rejected the argument that the differing site conditions clause of the prime contract was incorporated by reference into the subcontract, it relied upon the case of Southern Fireproofing Co. v. R. F. Ball Construction Company,³⁰ which had held that a subcontractor was not entitled to recover delay damages caused by purportedly differing site conditions. In Southern Fireproofing, the court specifically refused to find that the subcontractor derived any protection from the prime contract's differing site conditions clause. However, in Southern Fireproofing, there was little reason to apply equitable principles because the record indicated that before the subcontract was executed, the subcontractor was already aware of the problems with the subsurface conditions.³¹ Therefore, it was more appropriate for the court to require an express clause before it would find that the prime had agreed to protect the subcontractor.

In W. Wright v. Korshoj, there was no indication that the subcontractor had any prior knowledge of the differing site conditions, so there was no real reason to require an express clause in the subcontract since the terms of the

prime contract had already been incorporated by reference. By ruling as it did, the court allowed the prime contractor to recover his own delay damages from the government but did not require the prime contractor to pay for the full value of the subcontractor's efforts even though the government had already agreed to reimburse the prime contractor for this value through the equitable adjustment in the differing site conditions clause.

Although it can be argued that the court did not reach an inequitable result in this case but only decided that the subcontractor made a bad business decision, there is still reason to criticize the court's opinion. In particular, the opinion appears to be incorrect in the manner in which the court distinguished this case from United States ex rel Marianna v. Piracci Construction Co.,³² and United States ex rel. Otis Elevator Co. v. Piracci Construction Co.³³ These are two cases which had recently held that the prime contractor's surety could be liable for delay damages caused by the government.

In distinguishing those two cases, the Nebraska Supreme Court said:

Although these two cases generally support the proposition Wright takes in its brief, it should be noted that they arise under the Miller Act. The " . . . key to recovery under the Miller Act is not the theory upon which liability is predicated, but the actual investment by a subcontractor of time and materials in a federal

project." 405 F. Supp. at 909. "[P]laintiff's cause of action is not defeated by such technical exercises as analyzing whether the claim arose within or without the contract or by determining if the added costs were indispensable to satisfactory contractual performance." 405 F. Supp. at 907. Thus the holding of the Piracci cases is relevant to cases arising under the Miller Act, which provides a statutory cause of action, but does not resolve the issue in this case, which is one based solely on the subcontract between Korshoj and Wright.³⁴

This distinction based upon the Miller Act is questionable because the surety's liability to the subcontractor should not be any greater than the prime contractor's. As stated in the Otis Elevator v. Piracci case, "while the particular theory of liability advanced is not significant, the subcontractor must nevertheless establish liability on the part of the prime contractor."³⁵

The theory of liability of the prime contractor in the two Piracci cases is restitution for unjust enrichment. The court emphasized in the first case that plaintiff was not seeking unrealized profit but was only claiming for labor and materials and related expenses.³⁶ Such is typical of the nature of the enrichment measure of restitutionary relief as opposed to the reliance measure frequently utilized when dealing with rescission and restitution.³⁷ Furthermore, in the second Piracci case the court emphasized that the equities balanced in favor of finding for the subcontractor because the subcontract did not absolve the

prime contractor from possible liability for delay and the prime contract did not shelter the government. Therefore, there was no reason to fear that the prime contractor would be treated unfairly if the court granted the relief requested by the subcontractor.³⁸

From the foregoing, it can be seen that it is still unclear whether the subcontractor will be able to recover from the prime contractor for breach of contract when the actual fault lies in the hands of the government. The success of the action will depend upon the subcontractor's ability to demonstrate that recovery is available through a remedy granting clause in the subcontract or that the government actions resulted in the breach of an express or implied promise by the prime contractor. Finally, recovery may be allowed if it is demonstrated that the equities surrounding the harm caused by the government justify allowing recovery by the subcontract.

Although gaining recovery from the prime contractor for government caused harm is difficult enough, the situation is further complicated by the frequent use of exculpatory clauses in government subcontracts. Such clauses normally provide that the prime contractor will be absolved from liability for damages caused by the government. The effect such clauses may have on the subcontractor's ability to recover from the prime contractor will be examined next.

Effect of Exculpatory Clauses

In Chapter I, there was some discussion about the effect of exculpatory clauses such as those contained in Severin v. United States³⁹ and Donovan Construction Company v. United States.⁴⁰ There it was pointed out that because such clauses are enforceable, a clause which totally exculpated the prime contractor from liability to the subcontractor would actually preclude the prime contractor from sponsoring the subcontractor's breach of contract claim against the United States. The reason for this being that the prime contractor could not prove that he was actually damaged by the government breach. Because of this harsh result, the parties developed partial exculpatory clauses which provide that the prime contractor will only be liable to the subcontractor to the extent that the prime contractor is able to recover from the government on behalf of the subcontractor. It has been held that such a clause does not prevent the prime contractor from sponsoring the subcontractor's breach of contract suit.⁴¹

As discussed in Chapter I, the use of such clauses in government subcontracts is common, and is usually part of a general agreement between the parties concerning sponsorship of the subcontractor's claims against the government. On the one hand, the prime contractor agrees to sponsor the

subcontractor's claims without having to worry about whether the action could have an adverse impact upon him if the subcontractor subsequently decided to bring a breach of contract action against him. At the same time, the prime contractor is also able to provide a service to the subcontractor which should assure the subcontractor that he will be treated fairly on the project. From the subcontractor's point of view, although it appears that he has forfeited a potentially valuable remedy against the prime contractor, the cases discussed earlier in this chapter illustrate that the remedy against the prime contractor may not, in fact, be so valuable. At the same time, the subcontractor gains the relative ease in which the government's disputes procedure operates, as well as the assurance that a judgment in his favor will be collectible.

The clauses used in the Severin and Donovan cases are directly analogous to the "no damage for delay" clauses utilized frequently in commercial contracts. Therefore, a brief examination of the treatment the courts have given these commercial clauses should provide assistance in predicting the situations in which the government contracts exculpatory clauses will be enforced.

Generally, such "no damage for delay" clauses are not against public policy, and will be enforced.⁴² In Lichter v. Mellon-Stuart Company,⁴³ the general rule was stated as follows:

Ordinarily, a general contractor is liable to a subcontractor for damages resulting from delays not attributable to the latter; however, this right to recover damages may be validly precluded by the provisions of a contract.⁴⁴

In that case, it was held that a clause which expressly provided that a subcontractor was only entitled to additional time for delays caused by acts of the owner or the contractor prevented the subcontractor from collecting delay damages.

Although such clauses will be enforced, they are usually narrowly construed because of their harsh effect.⁴⁵ As stated E. C. Ernst, Inc. v. Manhattan Construction Company of Texas:⁴⁶

Given their harsh effect, courts will strictly construe such provisions but generally enforce them absent delay (1) not contemplated by the parties under the provision, (2) amounting to an abandonment of the contract, (3) caused by bad faith; or (4) amounting to active interference.⁴⁷

In applying the above rules to the typical agreement in the government subcontract, it would be difficult to argue that a delay caused by the government would be outside the contemplation of the parties because the exculpatory clause usually deals directly with government caused damages. In light of the holdings of cases such as McDaniel v. Ashton-Mardian and G.C.S. Inc. and J.S.C. Inc. v. Foster Wheeler Corp.,⁴⁸ that the prime contractor's acceptance of numerous government change orders does not amount to active

interference in the performance of the subcontract, it would appear that the exculpatory clause will be enforced unless abandonment of the contract or bad faith can be shown.

An example of the type situation where the government action could be found to have resulted in an abandonment of the subcontract would be the issuance of cardinal changes by the government which were accepted by the prime contractor even though they had a direct impact upon the subcontractor.⁴⁹ Another example might be where the prime contractor tolerated an unreasonably long government delay. It might even be argued that by allowing such actions to damage the subcontractor, the prime contractor acted in bad faith. It would certainly seem to be bad faith if the prime contractor actually failed to sponsor the subcontractor's claim, thus preventing him from being able to recover from the government. In each of these situations therefore, the existence of an exculpatory clause should not prevent an action against the prime if the logic of the E. C. Ernst Inc. v. Manhattan Construction Company of Texas case is followed.

Breach of Duty to Represent the Subcontractor

In the foregoing discussion concerning the enforceability of the exculpatory clause, it was pointed out that in certain circumstances an exculpatory clause would

not be enforced. When that happens, the end result will be that the subcontractor will not be precluded from suing the prime contractor and recovering damages if he can demonstrate that there was a breach of the subcontract. As seen thus far, there may be some difficulty in demonstrating this.

However, rather than seeking recovery from the prime contractor in this manner, another possibility may be to justify recovery against the prime contractor based upon his failure to honor the sponsorship agreement. It could also be argued that the sponsorship agreement created a duty to represent the subcontractor before the government and to act in his best interests. If such a duty was recognized, then recovery could be allowed if the subcontractor could demonstrate a reasonable likelihood of success against the government if the claim had been properly sponsored. This would be an easier burden to meet than attempting to show that the prime contractor was responsible for the government's fault.

If this duty was recognized, it would not only provide an easier cause of action to prove, but it would also help prevent prime contractors from taking affirmative actions which also adversely affect the subcontractor's ability to recover from the government. For example, the prime contractor's acceptance of an equitable adjustment or his

acceptance of final payment from the government without consulting with the subcontractor and preserving his claims are but two actions which could lead to liability.

Although there are no recent cases which directly support the argument that such a duty exists, there are enough that imply the existence of such a duty to raise a valid argument. When the McDaniel v. Ashton-Mardian case was discussed earlier, it was mentioned that in addition to seeking consequential damages from the prime contractor on the theory that the subcontract provided for such recovery, the subcontractor also sought recovery based upon a tort theory. He argued that the government changes were cardinal changes and the prime contractor's negligence in accepting them precluded the subcontractor from collecting the consequential damages which were caused by those changes.

In order for this tort theory to be successful, the court would have to find that the prime contractor owed a duty to the subcontractor to object to those cardinal changes. This theory was not rejected by the court, but instead the court found that there was no basis for liability because the changes were not cardinal changes.

There are other, older cases, which have found that when the subcontract incorporates the terms of the prime contract and requires the subcontractor to perform changes dictated by the owner in exchange for an equitable adjustment, then,

the prime contractor assumes an agency type relationship with the subcontractor that requires him to sponsor the subcontractor's claim against the owner.⁵⁰ If such a relationship were recognized, there clearly would be a basis for holding the prime contractor to a high standard of care in preserving the subcontractor's claims against the government.

There are, of course, weaknesses in the argument that the prime contractor should be held to such a standard. First, the fairness of putting the prime contractor in such a position is questionable when it is realized that the government is also expecting the prime contractor to act on its behalf in certain dealings with the subcontractor. For example, DAR §23-203 provides that the contracting officer should not agree to deal directly with subcontractors because the government is entitled to the management services of the prime contractor in settling subcontractor disputes. Secondly, the courts have been reluctant to find a fiduciary relationship between parties to a commercial contract unless there is evidence of a clear intent to establish such a relationship.⁵¹ Finally, there are no recent cases supporting this argument although one recent case appears to hold that there is no such duty.⁵²

Nevertheless, when the parties arrive at a sponsorship agreement which includes an exculpatory clause and the prime

gains protection from liability to the subcontractor for government caused harm while the subcontractor gains the opportunity to recover directly from the government, it would be logical to require that each side honors its obligations in good faith. When it is realized that unless the prime contractor acts in the subcontractor's best interests when representing him before the government, the subcontractor might forfeit all possibility of recovery, it does not seem unjust to require that the prime contractor not defeat or undermine the subcontractor's potential claim. Even the court in the W. Wright v. Korshoj case recognized the possibility for such an argument although it decided that nothing in that particular subcontract obligated Korshoj to submit Wright's claims to the government.⁵³

As stated earlier, in order for the subcontractor to justify recovery under this theory, he will have to show that if his claim had been properly sponsored, he would have had some likelihood of success. Additionally, in light of the limited number of precedents supporting a cause of action based upon a breach of this duty, it is suggested that it be accompanied by an alternate theory of liability. It is also suggested that sponsorship agreements could be drafted in a manner which explicitly recognizes this duty.

Choice of Law and Exhaustion of Remedies

Although the subcontracts which have been discussed herein are under federal government prime contracts, they are generally considered to be private contracts which are not subject to the general body of federal contract law. Thus, ordinarily a suit between the prime contractor and subcontractor will be decided under state law,⁵⁴ and the parties will frequently designate which state law will control their disputes.⁵⁵ However, if there is sufficient federal interest in the outcome of the dispute, such as if the dispute involves a subcontract which was concerned with national security,⁵⁶ then federal law might apply. In another case, the EBCA applied federal law in resolving a dispute between a prime contractor and subcontractor because the board found that the subcontract reflected a strong federal interest because title to the items involved in the subcontract was passing directly from the subcontractor to the government and the dispute centered on the accuracy of the subcontractor's Certificate of Current Cost and Pricing Data, which was furnished in accordance with federal law.⁵⁷

If there is an agreement in the subcontract to resolve disputes between the subcontractor and the prime contractor though the use of arbitration, such an agreement will normally be enforced.⁵⁸ In government subcontracts, moreover, the requirement to arbitrate could be enforced in

federal district court because these contracts are likely to meet the requirements of the Federal Arbitration Act.⁵⁹

On the other hand, it is less clear whether a subcontractor will be required to pursue the disputes clause remedy of the prime contract prior to filing a breach of contract suit against the prime contractor. The same policy reasons which cause courts to enforce arbitration clauses also appears to apply to the disputes procedure. Moreover, since that procedure would in many cases also work to the subcontractor's benefit, there should be no problem for the subcontractor particularly if there was also an explicit clause requiring the prime contractor to sponsor the subcontractor's claims.⁶⁰

Generally, it can be seen from this discussion that the subcontractor's ability to recover from the prime contractor for government caused injury is far from complete. It may be limited by his inability to show sufficient fault on the prime contractor's part and it may also be limited by the prime contractor's ability to pay a judgment even if the subcontractor is successful in the litigation. The next chapter will discuss the remedy that some subcontractors have of recovering from the prime contractor Miller Act surety. This particular remedy, if available, will at least avoid the problem caused by the prime contractor's insolvency.

NOTES

¹See Witte, Dispute Settlement Under Government Subcontracts, 18 Arb. J. 193 (1963); See also, Crowell, Arbitrating Commercial Disputes: More Problems Than Promise, 15 Nat. Cont. Mgt. J. 1 (1981), for a general discussion and criticism of the arbitration process in commercial contracts.

²See 5 Corbin on Contracts §1102 (1964).

³Id. §1107 at 578.

⁴Most government subcontracts provide, either expressly or through the incorporation by reference of the terms of the prime contract, that the prime contractor may direct certain changes in the work and the subcontractor will receive an equitable adjustment in the price and time available to perform the subcontract.

540 U.S.C. §270a-e.

⁶For a discussion of such aspects of subcontract formation, see generally, Stokes, Legal Considerations of Construction Subcontracts (1975); and, Griffin, Marshall and Elger, Subcontract Risk Allocation, The Prime Contractor's Approach, 78-6 Construction Briefings, November, 1978.

⁷99 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944).

⁸138 Ct. Cl. 97, 149 F. Supp. 900, cert. denied, 355 U.S. 826 (1957).

⁹601 F.2d 155 (4th Cir. 1979).

¹⁰108 Ct. Cl. 70, 69 F. Supp. 409 (1947).

¹¹259 A.2d 833 (C.A.D.C. 1969).

¹²American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 292 F.2d. 640 (9th Cir. 1961); United States ex rel. Gray-Bar Electric Company v. J. H. Copeland & Sons Construction, Inc., 568 F.2d 1159 (5th Cir. 1978).

¹³Blake Construction Company v. C.J. Coakley Co., 431 A.2d 569 (C.A.D.C. 1981).

¹⁴303 F.2d 655 (6th Cir. 1962).

1511 Williston on Contracts §1296 at 57 (3d ed. 1961).

16Id. §1295 at 38-39.

17See generally Annot., 16 A.L.R. 3d 1252 (1967).

18357 F.2d 511 (9th Cir. 1966).

1940 U.S.C. §270 a-e.

20Until 1967, the "changes" clause of the government construction contract only provided an equitable adjustment for the direct costs attributed to the change and not any consequential damages. However, the current changes clause allows an equitable adjustment which includes the recovery of consequential damages. It is not clear whether cases which follow the McDaniel v. Ashton-Mardian logic fully understand this distinction. Also, see generally, McWhorter, Suspension of Work/Edition II, 76-2 Briefing Papers (1976).

21317 U.S. 61 (1942).

22McDaniel v. Ashton-Mardian, 357 F.2d 511, 517 (9th Cir. 1966).

23Id.

24230 Ore 295, 364 P.2d 604 (1961)

25Id. at 364 P.2d 608.

26526 F.2d 108 (10th Cir. 1975), cert. denied 429 U.S. 866 (1976).

27Id. at 115.

28197 Neb. 692, 250 N.W.2d 894 (1977).

29Id. at 250 N.W.2d 898.

30334 F.2d 122 (8th Cir. 1964).

31Id. at 127.

32405 F. Supp. 904 (D.D.C. 1975).

33405 F. Supp. 908 (D.D.C. 1975)

34W. Wright v. Korshoj, 250 N.W. 2d at 900.

- 35Otis Elevator v. Piracci at 909.
- 36Marianna v. Piracci at 905.
- 37See Corbin on Contracts §1106 (Supp. 1982).
- 38Otis Elevator v. Piracci at 909-910.
- 3999 Ct. Cl. 435 (1943), cert. denied, 322 U.S. 733 (1944).
- 40138 Ct. Cl. 97, 149 F. Supp. 900, cert. denied, 355 U.S. 826 (1957).
- 41Id.
- 42See generally Annot., 74 A.L.R. 3d 187 (1976).
- 43193 F. Supp. 216 (W.D.Pa. 1961).
- 44Id. at 221.
- 4574 A.L.R. 3d, supra note 42 at 254.
- 46551 F.2d 1026 (5th Cir. 1977).
- 47Id. at 1029.
- 48437 F. Supp. 757 (W.D.Pa. 1975).
- 49Peter Kiewit Sons' Co. v. Summitt Construction Co., 422 F.2d 242 (8th Cir. 1969).
- 50Allegheny County Housing Authority ex rel. Dobson v. Caristo Construction Co., 90 F. Supp. 1007 (W.D. Pa. 1950); Dodge v. Harbor Boat Building Company, 99 Cal. App. 2d 782, 222 P.2d 697 (1950); Boomer v. Abbott, 121 Cal. App. 2d 449, 263 P.2d 476 (1953); United States ex rel. T.M. Page Corporation v. R. Hensler and General Insurance Company of America, 125 F. Supp. 887 (S.D. Cal. 1954).
- 51Teledyne Industries, Inc. v. Eon Corporation, 373 F. Supp. 191, 201 (S.D.N.Y. 1974).
- 52Clifton D. Mayhew, Inc. v. Blake Construction Company, 482 F.2d 1260 (4th Cir. 1973). However, a close reading of this case indicates that it only stands for the proposition that a particular clause in the contract between those parties

did not create a duty on the part of the prime contractor to present a claim on the subcontractor's behalf.

⁵³W. Wright v. Korshoj, 250 N.W.2d at 901.

⁵⁴Bank of America v. Parnell, 352 U.S. 29 (1959); Peter Kiewit Sons' Co. v. Summitt Construction Co., 422 F.2d 242 (8th Cir. 1969).

⁵⁵See Greenberg, Construction Subcontract Terms, 72-3 Briefing Papers at 7 (June 1972)

⁵⁶American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 229 F.2d 640 (9th Cir. 1961).

⁵⁷Cemco, Inc., EBCA 4-2-75, 76-1 BCA ¶11,702 (1976); See also Gaede & Bynum, Federal Procurement Law -- Dispute Resolution and the Developing Federal Common Law, 27 Ala. L. Rev. 1 (1975); Pofcher, The Choice of Law, State or Federal, in Cases Involving Government Contracts, 12 La.L. Rev. 37 (1951).

⁵⁸Humphreys & Harding, Inc. v. Pittsburg - Des Moines Steel Co., 397 F.2d 227 (4th Cir. 1968).

⁵⁹ 9 U.S.C. §§1-14. See also, Crowell supra note 1 at 2.

⁶⁰ See Griffin, Marshall and Elger, supra note 6 at 9-10.

CHAPTER III

RECOVERY FROM THE MILLER ACT SURETY

In addition to the traditional judicial and administrative remedies available to the subcontractor on a government project, a number of subcontractors have been provided with an additional remedy of recovery from the prime contractor's Miller Act surety.¹ When this remedy is available, it offers the subcontractor the assurance that if he is successful in proving the prime contractor's liability for his damages, there will be sufficient funds available to satisfy the judgment. This eliminates one of the most common problems facing subcontractors because one frequent cause of prime contractor default is his insolvency.

Recovery from the Miller Act surety is a unique federal remedy which is only available to those who furnish labor or materials for federal government contracts for the construction, alteration, or repair of any public building or public work. There are a number of procedural requirements which must be met in order to recover under the Act, the most important of which is that the Act has only a

one-year statute of limitations for first-tier subcontractors. This time period begins to run from the time the last work is done on the contract by the subcontractor.²

The Remedy In General

The statute reads in pertinent part:

A(a) Before any contract, exceeding \$25,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds,

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person.³

B(a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under §270a of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him....⁴

As the above language makes clear, the remedy is available to those who provide labor and materials on certain federal construction or public works projects.⁵ According to the statute, the federal district court where the contract was

performed is the appropriate forum to seek relief, irrespective of the amount of money involved in the controversy or the citizenship of the parties. The Act provides that the plaintiff is entitled to bring the action in the name of the United States, but this does not imply any government involvement in the case, and does not prevent the United States from assuming the prime contractor's defense of the suit pursuant to a contractual right.⁶ Finally, because the Act speaks in terms of recovering amounts justly due for labor and materials furnished for the project, it is clear that the remedy is restitutionary in nature.

Congress passed the Miller Act to provide an extra degree of protection for laborers and materialmen on government construction projects because those individuals do not have the protection of state mechanics lien statutes available to them.⁷ Because the statute is remedial in nature, it has been liberally construed.⁸ However, it must be remembered that the Act only permits recovery from the bond for just compensation for labor and materials furnished for the project.⁹

The Miller Act remedy is not exclusive and an action for recovery from the surety may be combined with a straight breach of contract action or other action against the prime contractor. In that case, the extra action will be heard in

the appropriate district court if there is diversity of citizenship, or if the state claim arises out of the same facts and the state issues do not dominate the Miller Act claim.¹⁰ The non-exclusive nature of the remedy is demonstrated by the case of United States ex rel. Sunworks Division of Sun Slector Corporation v. Insurance Company of North America, Forest Builders Inc., Tectonics, Inc. of Florida, Fortec, a Joint Venture, and Welco Mechanical Contractors, Inc.,¹¹ where a supplier to a subcontractor sought payment for materials furnished on a government construction project. The supplier sought relief based upon either the Miller Act, or in quantum meruit. The District Court dismissed the case after deciding that the supplier had not followed the proper procedures to preserve his Miller Act claim. However, the Court of Appeals reversed the trial court because the trial court's dismissal implied that the Miller Act provided the prime contractor with an exclusive remedy and such an implication was incorrect. The facts indicated that the supplier may have a valid claim based upon an "unjust enrichment" theory, and the court should have allowed him to pursue this claim.¹²

Labor and Materials Furnished For the Project

A great deal of the litigation concerning the surety's liability under the Miller Act has centered around the scope

of the protection of every person "...who has furnished labor or material in the prosecution of the work."¹³ Generally, it has been found that the labor and materials furnished for the project will not actually have to be incorporated into the project as long as there was a reasonably good faith belief that they would be so incorporated. Thus, the subcontractor or supplier would be protected if he had a good faith belief even though the materials were subsequently diverted by the prime contractor, or erroneously ordered and not used.¹⁴

However, more controversy arises concerning labor or materials necessary for the prosecution of the work but which are not actually a part of the project.¹⁵ Examples of such costs are transportation costs, food and lodging expenses, insurance, rentals, and capital equipment.¹⁶ The cases seem to focus upon whether the costs incurred were necessary and integral to the performance of the contract, in which case recovery will be allowed. On the other hand, recovery is likely to be disallowed if the cost is not found to be for an item necessary and integral to the project, or consumed therein. This has frequently precluded recovery for such costs as insurance costs, and costs for capital equipment not consumed in the project.¹⁷

Types of Claims

Because the Miller Act provides that the surety is liable for the value justly due for labor and materials furnished in the project, a claim based upon tortious injury by the prime contractor would be beyond the coverage of the Act.¹⁸ But if the subcontractor has performed in accordance with the terms of the contract but has not been paid by the prime contractor, the Miller Act clearly provides relief. Absent other factors, that relief would probably require the surety to pay the contract price for the labor or material furnished. If the subcontractor has performed extra work, that will be paid for as agreed under the contract. If there has been no agreed price, then the surety will probably be liable for the value of that extra work, measured in quantum meruit.¹⁹ Additionally, the surety may be liable in quantum meruit after the prime contractor has materially breached the contract.²⁰

The case of United States ex rel. Coastal Steel Erectors v. Algernon Blair, Incorporated²¹ is a leading case supporting the proposition that the subcontractor may recover in quantum meruit from the surety when the prime contractor's material breach has justified the subcontractor's termination of the contract. The subcontractor had terminated his performance on the construction project after he had completed about

twenty-eight per cent of the job. His reason for terminating was that the prime contractor had wrongfully refused to pay rental costs for some equipment furnished by the subcontractor. The court found that this failure to pay these costs was a material breach of the subcontract and the subcontractor was able to recover in quantum meruit even though he would have lost money had he completed performance of the contract. The court found that it was a well settled rule that upon material breach of contract, the promisee has the option of foregoing suit on the contract and claiming instead for the reasonable value of his performance up to that time.²² The court went on to say that this liability attaches to the surety and that such an interpretation is consistent with the liberal construction which should be given the Miller Act.²³

In another case, quantum meruit recovery from the surety was allowed after the subcontractor's performance had been delayed by unusually severe weather and other hardships to the point where abandonment of the contract was justified. The court found that because of these conditions, neither side was in breach of contract, but the subcontractor was entitled to recover the value of his labor and materials furnished up to that point, under the Miller Act.²⁴ This case is similar to the W. Wright, Inc. v. Korshoj Corporation case which was discussed in Chapter II. Both of

the cases were concerned with delay damages caused through no fault of the prime contractor. In the W. Wright, Inc. v. Korshoj Corporation case, which was a state action for delay damages, relief was denied. In this case, under the Miller Act, quantum meruit recovery was granted. Although the Korshoj court would probably argue that relief was granted in this case because it was a Miller Act case, the only real basis for distinguishing the two cases is that in W. Wright v. Korshoj Corporation, the court ruled that the Differing Sites Conditions clause of the prime contract had not been incorporated into the subcontract, whereas this case found that it had been so incorporated.

The right to recovery from the surety in quantum meruit is not all encompassing. The court in United States ex rel. Mobile Premix Concrete v. Santa Fe Engineers, Inc.,²⁵ summarized the situations where such recovery has been allowed:

Recovery on the basis of quantum meruit, or for the reasonable value of services provided, has been permitted under the Miller Act when there was no express contract between the parties regarding the work performed,..., or where extra labor was performed or extra materials furnished which were not contemplated by the original contract.... Recovery on the basis of quantum meruit has also been permitted where there has been a breach of contract...

However, the Miller Act does not substitute a cause of action in quantum meruit in derogation of the provisions of an express contract.²⁶

Then the court decided that the above rules did not allow plaintiff in the case to recover the additional costs caused by the delay in the performance of the contract. The court's logic was that the Miller Act did not make the surety liable for breach of contract damages when the contract had already been fully performed and the terms of the contract governed the surety's liability. The court indicated that plaintiff's proper remedy was a breach of contract suit against the prime contractor.

There has been a split of authority on the issue of whether the surety is liable for breach of contract damages.²⁷ On the one hand, a number of cases have denied such liability on the ground that the surety is only liable for the value of labor and materials furnished in the project and that breach of contract damages are not expenses for labor and materials. Further, in denying delay damages, these decisions consider them to be beyond performance originally contemplated by the parties, and therefore beyond the surety's liability.²⁸

On the other hand, cases like United States ex rel. Marianna v. Piracci Construction Company²⁹ have followed a more simplistic view, in an attempt to be more in keeping with the remedial nature of the statute. These allow the subcontractor to recover delay damages from the surety when

those damages represent the subcontractor's actual increased expenses incurred in furnishing labor and materials over an extended period of time.³⁰ This theory would not allow the subcontractor to recover extra profit, but it would be consistent with the cases granting quantum meruit recovery to the subcontractor from the surety for the reasonable value of his services and materials at the time and place rendered.

A comparison of two cases may be helpful to illustrate the difference in results under the two rules. In United States ex rel. E&R Construction Company v. Guy H. James Construction Company,³¹ a subcontractor sought quantum meruit relief from the prime contractor and his surety on the basis that the prime contractor's active interference with his performance constituted a material breach of the subcontract. This was a dredging subcontract and the prime was alleged to have actively interfered with the subcontractor's performance by failing to promptly remove large quantities of shot rock he had wrongfully deposited on the cofferdam. In addition the subcontractor claimed that the prime's actions caused harm to his equipment.

The court agreed that the prime contractor had materially breached the subcontract, thus justifying quantum meruit relief from the prime contractor. In addition the court found that surety was also liable for the reasonable

value of the labor, material and services furnished by the subcontractor but that this did not include damages incurred because of the time equipment was idled by the prime's actions, or damages for harm to the equipment. The court distinguished the damages for the standby time from value for labor and materials without clearly stating a rationale, except to imply that delay damages were distinguishable from value for labor and materials because in determining the proper value for labor and materials furnished, only items which were indispensable to the work could fall within the meaning of the term. The court reasoned that this could not include damages incurred by the prime's breach of contract or negligent harm to equipment.

On the other hand, the case of United States ex rel. Marianna v. Piracci Construction Company involved a claim for delay damages consisting of increased costs of labor, materials, field operations, and indirect expenses all incurred because of a delay caused by the government. The surety argued that he was not liable for these increased costs because his liability was tied to the work and amounts specified in the contract. The court disagreed and said the surety could be liable for these increased costs caused by delay because these costs reflected the actual costs of the labor and materials when they were furnished and the subcontractor bore no responsibility for the delays which caused the cost increases.

The results of these two cases are quite different, and it is clear that the latter is to be favored by subcontractors. In addition, it also appears that this result more closely approximates the statute's intent to protect those who furnish labor and materials for government projects. It also appears to be in accord with the view of the Supreme Court that the statute should be liberally construed because it is remedial in nature.³² Although the court in the E&R Construction case was correct in excluding the damage to the subcontractor's equipment caused by the prime contractor's negligence, there appears to be no reason why the court refused to consider delay damages as simply increasing the value of labor and materials at the time rendered. The view of the Marianna v. Piracci court appears to be more equitable particularly when it is remembered that the court is not creating a new theory for holding the prime contractor liable, but only insuring that if that liability is proven, the subcontractor will be able to collect his judgment.³³ Although the surety's liability is somewhat extended, this appears to be most equitable because the surety's business is to guaranty the prime contractor's payment of debts and the surety also has his subrogation rights available to try to make himself whole.

Choice of Law and Exhaustion of Remedies

The Supreme Court has stated in F.D. Rich Co. v. Industrial Lumber Co.³⁴ that:

The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law.³⁵

Consequently, the Court ruled that the issue of whether attorney's fees should be awarded should not be dependent upon the public policy of a particular state but should be decided in accordance with a uniform federal rule. The Court then adopted the so-called American rule which generally provides for no recovery of attorney fees as part of a judgment in the absence of a statute or enforceable contract right providing for such an award.³⁶

It has not been clear whether the ruling in F.D. Rich Co. v. Industrial Lumber Co. was intended to require the application of federal common law to all Miller Act cases, or whether it only meant to deal with the issue of awarding attorney fees.³⁷ Perhaps the conflict has been most succinctly stated by the United States District Court for the District of Colorado when it said:

The most interesting question presented is whether federal law controls over state law in Miller Act cases. Some circuits have held that as to subcontracts, state law controls when construction of the Miller Act is not in issue and the United States is not a party to the subcontract. Other circuits have held that federal law controls in all actions under the

Miller Act. These cases are collected in U.S. for the Use of Building Rentals Corp. v. Western Casualty & Surety Co., 498 F.2d 335, 338 (9th Cir. 1974). The tenth circuit has not decided either way. See, Burgess Const. Co. v. M. Morrin & Son Co., Inc., 526 F.2d 108 (10th Cir. 1975), cert. denied, 429 U.S. 866, 97 S.Ct. 176, 50 L.Ed.2d 146 (1976). However, it seems clear that when there is a distinction between federal and state substantive law, federal law controls and the interstices may be filled by incorporating state law. U.S. v. Algernon Blair, Inc., 479 F.2d 638 (4th Cir. 1973), 26 ALR Fed 741; U.S. for the Use of Astro Cleaning & Packaging Corp. v. Jamison Co., 425 F.2d 1281 (6th Cir. 1970).³⁸

It is clear that the government has a strong interest in the outcome of Miller Act cases for the same reasons that Congress chose to create this federal remedy in the first place. That is, the remedy ensures that covered contractors and materialmen will be protected to the same extent as their counterparts on private construction projects. In addition, the existence of the remedy encourages such persons to be willing to work on covered projects and also helps to ensure that the work in such projects will proceed in an orderly manner. It appears that one way to protect these interests is to interpret the meaning of the Act and the extent of the surety's liability by using the uniform rules available in federal common law.

On the other hand, it appears to be more rational to utilize state law to interpret the rights and duties of the parties to the subcontract when there is no direct federal interest in the outcome and the government is not a party to

the suit. By following this logic, the courts will probably be using the contract law that the parties understand best, and their rights and duties under the subcontract will be subject to the same choice of law rules, regardless of whether the Miller Act is a factor. This wouldn't harm the previously mentioned government interest which really only relates to protecting the subcontractor's right to be paid sums he is supposed to receive.

The same interests that call for the use of federal law to interpret the surety's liability under the Miller Act also cause the courts to be extremely reluctant to find that a subcontractor has waived his Miller Act remedy, or that he must exhaust administrative remedies before he can seek relief under the Miller Act. For example, in United States ex rel. B's Company v. Cleveland Electric Company of South Carolina, the court rejected an argument that because the subcontractor was bound by the terms of the prime contract, he was also bound to pursue the prime contract's disputes clause remedy prior to seeking relief under the Miller Act.

The court reasoned that:

If the subcontractor is not paid, his only remedy is a suit under the Miller Act. He has no lien and no claim against the government. This is the reason for the Act and, while the right to sue may be waived by clear and express provisions in the contract between the prime contractor and the subcontractor, no such provisions are contained in the contract at issue here and no such drastic curtailment of the subcontractor's rights will be

read into a general agreement to be bound by the terms of the prime contract insofar as they reflect the work of the subcontractor.⁴⁰

This rule has been generally followed,⁴¹ and when the courts find that the subcontractor has expressly agreed to arbitrate controversies, or has even actively sought arbitration, he may still file a Miller Act claim. However, the Miller Act suit will, in such a situation, be stayed until the administrative proceeding is complete.⁴² The courts normally find this rule to be necessary because of the relatively short time in which an action may be brought under the Act.

NOTES

140 U.S.C. §270a-e.

240 U.S.C. §270b.

340 U.S.C. §270a.

440 U.S.C. §270b.

⁵This would include first-tier subcontractors. The statute also provides a remedy for non-payment of those who did not deal directly with the prime contractor, although the particular procedural requirements of this aspect of the Miller Act will not be addressed here. However, an occasional case involving such lower-tier subcontractors or materialmen may be discussed if it appears that the case stands for a proposition which is equally applicable to first-tier subcontractors.

⁶United States ex rel. Rudnick & Co. v. Daniel, Urbahn, Seelye & Fuller, 357 F. Supp. 853 (N.D. Ill. 1973).

⁷Tracy, et. al., Subcontractor Miller Act Rights, 78-1 Construction Briefings (June, 1978).

⁸F.D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116, 124 (1974); MacEvoy Co. v. United States ex rel. Tomkins Co., 322 U.S. 102, 109-111 (1944).

940 U.S.C. §270b.

¹⁰United States ex rel. Mandel Brothers Contracting Corp. v. P.J. Carlin Construction Co., 254 F. Supp. 637 (E.D.N.Y. 1966); see also 2 Nash and Cibinic, Federal Procurement Law, Ch. 26 at 1781 (3d ed. 1980).

¹¹30 Cont. Cas. Fed. (CCH) ¶70,497 (10th Cir. 1982).

¹²Id. at 75,511.

¹³40 U.S.C. §270b. For a detailed discussion of the cases which have dealt with this issue, see Nash and Cibinic, supra note 10 at 1773-1775.

¹⁴Nash and Cibinic, supra note 10 at 1773.

¹⁵Id. at 1773-1774.

¹⁶Id. at 1774.

¹⁷Id. at 1774-1775; see also Brady, Bonds on Federal Government Construction Contracts: The Surety's View, 46 N.Y.U. L. Rev. 262, 267 (1971).

¹⁸Tracy, supra note 7 at 6.

¹⁹Nash and Cibinic, supra note 10 at 1777.

²⁰See generally, Annot. 26 A.L.R. Fed 746 (1976).

²¹479 F.2d 638 (4th Cir. 1973).

²²Id. at 640.

²³Id. at 641.

²⁴Steenberg Construction Co. v. Prepakt Concrete Co., 381 F.2d 768 (10th Cir. 1967).

²⁵515 F. Supp. 512 (D. Colo. 1981).

²⁶Id. at 515-516.

²⁷For an excellent discussion of this and other cases denying recovery from the surety for delay damages, see Braude, The Surety's Liability Under the Miller Act for "Delay Damages," 36 Fed. B.J. 86 (1977).

²⁸L.P. Friedstedt Co. v. U.S. Fireproofing Co., 125 F.2d 1010 (10th Cir. 1942); United States ex rel. Gutman v. P.J. Carlin Construction Co., 254 F. Supp. 1001 (D.N.Y. 1965); Arthur N. Olive Co. v. United States ex rel. Marino, 297 F.2d 70 (1st Cir. 1962); United States ex rel. E&R Construction Co. v. Guy H. James Construction Company, 390 F. Supp. 1192 (M.D. Tenn. 1972), aff'd. 439 F.2d 756 (6th Cir. 1973).

²⁹405 F. Supp. 904 (D.D.C. 1905); see also, United States ex rel. Otis Elevator Co. v. Piracci Construction Co., 405 F. Supp. 908 (D.D.C. 1975); and, United States ex rel. Heller Electric Co. v. William F. Klingensmith, Inc., 670 F.2d 1227 (D.C. Cir. 1982).

³⁰Marianna v. Piracci at 906.

³¹390 F. Supp. 1193 (M.D. Tenn. 1972), aff'd 489 F.2d 756 (6th Cir. 1973).

³²F.D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116 (1974).

³³Marianna v. Piracci at 906. See also Otis v. Piracci at 909, which reiterated the proposition that although the theory of liability was unimportant, nevertheless the subcontractor must still establish the prime contractor's liability.

³⁴417 U.S. 116 (1974).

³⁵Id. at 127.

³⁶Id. at 126.

³⁷Burgess Construction Company v. M. Morrin & Son Co., 526 F.2d 108, 114n. (10th Cir. 1976), cert. denied, 429 U.S. 866 (1976).

³⁸United States ex rel. Mobile Premix Concrete, Inc., v. Santa Fe Engineers, Inc., 515 F.Supp. 512, 514-515 (D. Colo. 1981).

³⁹373 F.2d 585 (4th Cir. 1967).

⁴⁰Id. at 588.

⁴¹Warriors Constructors, Inc., v. Harders, Inc. 387 F.2d 727 (5th Cir. 1967); United States ex rel. Industrial Contractors Corporation v. William Clairmont, Inc., 341 F. Supp. 940 (D. Neb. 1972); Fanderlik-Locke Co. v. United States ex rel. Morgan, 285 F.2d 939 (10th Cir. 1960).

⁴²United States ex rel. Portland Construction Co. v. Weiss Pollution Control Corp., 532 F.2d 1009 (5th Cir. 1976). See also Nash and Cibinic, supra note 10 at 1786.

CONCLUSION

As long as subcontractors must establish privity of contract in order to recover directly from the government, they will face some challenge in order to insure that they are fully protected. Unlike the owner in private commercial contracts, the government maintains a great deal of control over subcontractors and imposes a number of special requirements upon them. Yet these rarely amount to sufficient contacts to lead a court to conclude that privity of contract has been established between the government and a subcontractor.

Nevertheless, the Commission on Government Procurement may not have been incorrect in refusing to recommend that subcontractors be granted direct access to the government's disputes procedures. Although the adoption of this recommendation would certainly have made matters simpler for government subcontractors, the Commission simply was not sure such a change was necessary because it was not convinced that subcontractors were frequently being treated inequitably.

Certainly, there is no need for a subcontractor to open

himself up to potentially inequitable treatment. He can avoid this by insuring that he has a subcontract which promises him every equitable adjustment that the prime contractor is entitled to receive from the government. Additionally, if the subcontract has a sponsorship agreement which clearly creates a duty on the part of the prime contractor to sponsor his claims, this will not only serve to clearly establish the availability of recovery against the government through the prime contractor, but may also provide a separate potential cause of action against the prime contractor if he should fail to fulfill his sponsorship obligations. This cause of action is more likely to be successful than one which attempts to tie the government's breach to the prime contractor, because it is not based upon government fault but instead upon an act or omission by the prime contractor.

If, however, the subcontractor is forced to rely upon a breach of contract suit or action for an equitable adjustment directly against the prime contractor, his chances of incurring an inequitable result increase. Now, he must face the uncertainties of whether he can establish that the government's action resulted in a breach of the subcontract, and this result may vary from jurisdiction to jurisdiction. Additionally, even if he is successful in establishing the prime contractor's liability, he may not be

able to collect the judgment because the prime contractor is insolvent.

For this latter reason, subcontractors working on projects covered by the Miller Act have an additional level of protection, in that they may be able to recover directly from the Miller Act surety. There have been some inconsistent results concerning the ability of subcontractors to recover breach of contract damages from the surety, but the recent trend seems to be that the subcontractor can recover such damages from the surety to the extent that they represent the value of labor and materials furnished for the project at the time they were furnished. This should be clearly set out as the theory of recovery in the Miller Act suit.

Finally, although the breach of contract area of recovery against the government has not been greatly enlarged over the years, subcontractors should not overlook the potential remedy of recovering from the government under the Federal Tort Claims Act. This remedy is not barred to subcontractors and should be utilized when the harm caused by the government can be attributed to certain tortious acts on the part of government employees. Additionally, it must be remembered that there are certain procedural prerequisites which must be met before recovery under the Federal Tort Claims Act will be allowed. The most important

of these is the requirement that the claim be submitted for administrative determination prior to the bringing of judicial action. Secondly, the judicial claim must be brought in federal district court, so an early decision must be made whether to proceed under a tort theory or contract theory. However, if the tort theory is pursued successfully against the government, the subcontractor will again be assured of collecting the judgment.

